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EMPLOYER ASSET REVERSIONS FROM TERMINATED PENSION PLANS

HEARING

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

COMMITTEE ON LABOR AND HUMAN RESOURCES UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

REVIEWING EMPLOYER ASSET REVERSIONS FROM TERMINATED PENSION PLANS

FEBRUARY 9, 1989

Printed for the use of the Committee on Labor and Human Resources

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EMPLOYER ASSET REVERSIONS FROM TERMINATED PENSION PLANS

THURSDAY, FEBRUARY 9, 1989

U.S. SENATE,
SUBCOMMITTEE ON LABOR,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:00 a.m., in Room 628, Dirksen Senate Office Building, Senator Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Present: Senators Metzenbaum and Jeffords.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator METZENBAUM. Good morning. Today the subcommittee resumes its consideration of the issue of overfunded pension plan terminations by employers who seek to recapture what are considered excess plan assets. While Congress continues to debate this issue, American workers and retirees continue to see their pension plans terminated and their retirement security jeopardized.

Frankly, I am sick of it and I am tired of it. Because the billions of dollars keep rolling out of these funds while the government sits on its hands and twiddles its thumbs.

When this Committee held its last hearing on the issue in 1987, 1.5 million workers had watched their employers recover $17 billion from pension plans. Today, a total of two million workers and retirees have seen their employers take $20 billion out of pension plans. So in less than two years another half a million workers have lost pension benefits. Why? So that the companies could run to the bank with $3 billion.

In addition to an increase in the number of workers who have lost benefits, a more troubling change is also occurring. Fewer of these employers are reestablishing new plans for their workers. Increasing numbers of healthy companies are using reversion money for general corporate purposes while their workers are left high and dry without any pension plan whatsoever. The argument is made that the money belongs to the employers. It was these workers who put in years of their lives in order to make the company what it is. And the companies become indifferent to the workers' concerns.

In 1986, 21 percent of employers taking reversions did not establish new plans. In 1987, it had increased to 26 percent, and in the first nine months of 1988, an alarming 37.5 percent of employers

did not establish new pension plans. Enough said for the compassion and fairness of America's industrial leaders.

Clearly, American workers are being hurt. Private pensions are a fundamental part of our retirement security system. Social Security barely gets most retirees to the poverty level. Millions of Americans depend upon private pensions to live out their retirement years on even a modest income.

Congress has been reviewing this problem for eight years—for eight years too long. At one point, the Reagan Administration indicated that they had some concerns and agreed there was some right in putting a halt to this question of ripping off these funds. It went to the domestic council or the business council in the White House, and at the last minute they flipped 100 percent and turned their backs on American workers.

And when those who had responsibility in Government said they did not agree with the solutions that were being reached, the Government did not change its position. So they left the Government instead.

In 1987, we came close to a solution. The Reagan Administration agreed that terminations and reversions threaten workers' benefit security and the stability of the private pension system. Legislation was passed by Congress in 1987, but it was deleted in the final moments during conference. So much for the efficacy and the effectiveness of the business lobby. In 1988, I tried to impose a moratorium on termination reversions. The Treasury Department agreed to suspend the issuance of all determination letters permitting employers to get a reversion until May 1, 1989.

While I recognize that it is early in the Bush Administration, May 1st will soon be upon us. I am hopeful that President Bush will favorably consider this issue and the threat it poses to our pension system. I believe we can find a middle ground that protects pensions and workers. Toward that end I intend to introduce a bill as soon as Congress returns from its February recess. I hope the Administration will work with me and that we can pass a bill before May 1st. American workers and retirees have waited far too long already.

I am hopeful that the Treasury Department will be cooperative, that the Labor Department will be cooperative, that the Administration will be cooperative and that equity and fairness prevail rather than the inequities that have prevailed for the last eight years as far as American workers are concerned.

[The prepared statement of Senator Metzenbaum follows:]

U.S. Senator Howard M.
METZENBAUM
of Ohio

Committees:
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Labor and Human Resources
Energy and Natural Resources
Select Committee on Intelligence

Chairmanships:
Subcommittee on Antitrust
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Regulation and Conservation

STATEMENT OF SENATOR HOWARD M. METZENBAUM

HEARING ON PENSION PLAN TERMINATIONS AND EMPLOYER REVERSIONS BEFORE THE SENATE SUBCOMMITTEE ON LABOR

THURSDAY FEBRUARY 9, 1989

Good morning. Today the Subcommittee resumes its consideration of the issue of overfunded pension plan terminations by employers who seek to recapture what are considered excess plan assets. While Congress continues to debate this issue, American workers and retirees continue to see their pension plans terminated and their retirement security jeopardized.

When this Subcommittee held its last hearing on the issue in 1987, 1.5 million workers had watched their employers recover $17 billion from pension plans. Today, a total of 2 million workers and retirees have seen their employers take $20 billion out of pension plans. So in less than two years another half a million workers have lost pension benefits. Why? So that their companies could run to the bank with $3 billion.

In addition to an increase in the number of workers who have lost benefits, a more troubling change is also occurring. Fewer of these employers are reestablishing new plans for their workers. Increasing numbers of healthy companies are using reversion money for general corporate purposes while their workers are left high and dry without any pension plan whatsoever. In 1986, 21% of employers taking reversions did not establish new plans. In 1987, it had increased to 26% and in the first nine months of 1988, an alarming 37.5% of employers did not establish new pension plans.

Clearly, American workers are being hurt. Private pensions are a fundamental part of our retirement security system. Social Security barely gets most retirees to the poverty level. Millions of Americans depend upon private pensions to live out their retirement years on even a modest income.

Congress has been reviewing this problem for eight years -- for eight years too long. In 1987, we came close to a solution. The Reagan Administration agreed that terminations and reversions threaten workers' benefit security and the stability of the private pension system. Legislation was passed by Congress in 1987 but it was deleted in the final moments during conference. In 1988, I tried to impose a moratorium on termination reversions. The Treasury Department agreed to suspend the issuance of all determination letters permitting employers to get a reversion until May 1, 1989.

While I recognize that it is early in the Bush Administration, May 1st will soon be upon us. I am hopeful that President Bush will favorably consider this issue and the threat it poses to our private pension system. I believe we can find a middle ground that protects pensions and workers. Toward that end I intend to introduce a bill as soon as Congress returns from its February recess. I hope the Administration will work with me and that we can pass a bill before May 1. American workers and retirees have waited far too long already.

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Senator METZENBAUM. This morning we have two witnesses from the Administration with us. I am very happy to welcome Mr. Dana Trier, Tax Legislative Counsel for the U.S. Department of Treasury in Washington. Mr. Trier, I would be very happy to hear from you, sir.

STATEMENT OF HON. DANA TRIER, TAX LEGISLATIVE COUNSEL, U.S. DEPARTMENT OF TREASURY, WASHINGTON, DC

Mr. TRIER. Thank you very much, Senator Metzenbaum. I am here to present the Treasury Department's views on this important policy issue. At the beginning I will summarize what our views are and our response to your basic questions and your release. Then I will describe a little bit the setting in which this problem arises, and finally describe the reasons for our views.

We at the Treasury Department continue to believe that the employer should, in fact, be entitled to the reversion of excess assets that occurs when some defined benefit plans are terminated and the liabilities are paid off to employees. Secondly, we will continue to interpret the amount of the reversion that is excess assets that is permitted to go to the employer in accordance with the long existing actuarial error regulation whether or not that continues to be called actuarial error or not is another question.

Third, although we too believe that this is an issue and all the issues surrounding reversions and terminations should continue to be monitored and considered, we at the Treasury Department at least do not believe this is the proper time to undertake a major policy initiative in this regard. First of all, just so that we are talking about a common set of facts, the basic thing we are talking about now is——

Senator METZENBAUM. Mr. Trier, has this been taken up at the highest levels? Because, I remember the President talking about this being a kinder, gentler Nation. Boy, you sure don't sound like you are talking as a kinder, gentler Nation. You are indifferent. You are worse than the previous Administration in those statements. I hope the Labor Department does not share your views. And I just have to say to you that I am so unbelievably disappointed in having Treasury come here this morning and tell me that they continue to believe that the employers will be entitled to the excess assets. And I want to be certain that the statement you are making has been cleared at all levels all the way up in the Administration.

Mr. TRIER. It is being cleared through OMB which you know solicits the views of all constituent parts in the Administration, yes, sir.

Senator METZENBAUM. Sad. Just a sad, sad commentary. The first hearing we have and this Administration takes such a position. Please proceed.

Mr. TRIER. I think perhaps we should get to the heart of the matter and respond to that sort of sentiment. We at the Treasury Department and at the Office of Tax Legislative Counsel are quite concerned with both having the viable private retirement planning system and having benefit security for employees. On the other hand, there are a variety of competing considerations in determin-

ing how we achieve the objectives that we all share. And in that respect, we believe that at least until we see how it operates now, for a couple years after recent legislation that the present system reflects a proper balance of competing considerations.

Just to get to the question of whether, in fact, we are being heartless or hurting the employee in this regard, we after all, do have a private retirement planning system that does not require of anybody that they maintain a qualified retirement plan, and certainly does not require them in choosing among the types of plans that they do entertain that they maintain a qualified defined benefit plan. And considering exactly what rights each of the constituent parties should have with respect to reversions and other considerations, we have to also take into account the incentive effect that the structure of the law would have.

And I would submit to you that at least now based on what we know when, for example, when considering the continued trend towards terminating defined benefit plans in general, apart from whether they are reversions, we have to take into account all the factors that may be having an impact on that trend which may include the types of regulations and rules to which the employers are subject.

Senator METZENBAUM. What are all those factors?

Mr. TRIER. Well, I think all those factors would include the fact that there are discrimination rules and Social Security integration rules arising out of 1986 legislation. There are new funding rules arising out of the 1987 legislation. The reversion excise tax which you know was originally 10 percent, is now 15 percent in 1987. To my mind there is no reason for me to believe that you would have fewer terminations of defined benefit plans by having the reversion of the excess assets go to somebody other than the employer.

Similarly, I would say that in terms of promoting benefit security, which is the notion that the benefit that is promised on a current basis actually be provided, that the PBGC now would have to pick up the failure to fund at various times. That it is in all our mutual interests to encourage funding in as rapid a pace as possible up to the 150 percent limit which was placed in 1987. So there are a variety of factors in a private retirement planning system.

Senator METZENBAUM. Is any of those factors, do you think the worker who has given 25 years of his life and has worked for the company and winds up with a pension of about $1,700 a year, as we had some people come before our Committee and testify. The senior vice president, I guess he was one of the top vice presidents of a company coming before us and saying he himself objected to it, indicating what a small pension he is getting.

The Washington Star's pension plan was terminated and had an agreement in their pension plan that the plan would not be terminated. Then Time Magazine buys the Washington Star and they do not terminate the pension plan. What they do is they first amend the plan because they say there was no prohibition on that. Then they go ahead and terminate it.

What about all the employees? What about concern for the employees, Mr. Trier?

Mr. TRIER. I consider the ultimate objective is to, in fact, to have a private retirement planning system that encourages benefit secu-

rity for the employees. And the question is how do you get there. That is after all what we are designing here is a supplemental retirement system for the employees. Now to allude to the Washington Star case which is a case that I have been familiar with for some years.

One of the effects is, as you know, the 1987 legislation. It is precisely to require that amendments to the plan which permit the reversion not occur at the last minute which they were allowed under the case law—under old law. And that is one of the little steps that we are taking in the last several years to define the proper balance between the interested employees, the incentives of the employers, et cetera. I think that is a very good thing, precisely the kind of thing that we continue to have to be attentive to.

The place where I strongly would disagree, as a matter of policy, is I do not think the long run objectives (which, believe it or not, I do think we share of benefit security) would be increased or served by having a rule that no matter what the employers' surplus is, that it is shared or goes completely to the employees.

Senator METZENBAUM. We have never argued that it goes completely to the employees. We think it ought to be shared. We made that clear. We have discussed that, but what you are——

Mr. TRIER. I find that a very blunt response to difficult competing considerations which I think the law attempts to balance.

Senator METZENBAUM. But the position that the Administration takes, as far as the Treasury Department is concerned, I will wait to hear from the Labor Department, is that once a retired employee gets to a certain point that that employee can be precluded from ever getting any inflationary increase, not withstanding the fact that the fund has inflated by reason of higher interest rates, higher stock market prices, whatever the case may be. And that the employee is the one who will be held at a firm level whereas the employer can have all the excess dollars. That is what the bottom line is of your position.

Mr. TRIER. I believe that the private retirement plan system will permit COLAs in some cases and not permit it in other cases, but I do not think some ad hoc rule which depends on what the investment results were of the plan and a variety of changes in funding rules and funding considerations should be the means by which we address those concerns.

Senator METZENBAUM. You said that in some instances it will permit COLAs. When you permit a termination and permit the employer to take all the excess dollars, and then the employee——

Mr. TRIER. Based on their accrued liability then.

Senator METZENBAUM. The employee then gets an annuity, and it is fixed in amount. There is no chance for that employee ever to get any adjustment in his or her pension.

Mr. TRIER. I understand that based on assuming there is a termination, assuming that the planned liability is as stated and does not include a COLA. I agree with that.

[The prepared statement of Mr. Trier follows:]

February 9, 1989

STATEMENT OF
DANA L. TRIER
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON LABOR
FOR THE
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

Mr. Chairman and Members of the Subcommittee:

I am here today at your request to present the Treasury Department's views regarding an employer's ability to recover assets from a terminated defined benefit plan. The Department continues to believe that an employer who terminates a defined benefit plan should be entitled to receive any assets remaining in the trust related to the plan after the satisfaction of all plan liabilities ("excess assets") as specified under law. The ability of an employer to recover excess assets upon termination of a plan should be preserved in order to ensure sound funding of pension plans and, ultimately, to protect employees' retirement security.

Background

A fundamental principle of the tax law applicable to pension plans is that plan assets must be used for the exclusive benefit of plan participants and their beneficiaries prior to the satisfaction of all plan liabilities. The term "liabilities" includes both the fixed and contingent liabilities that are provided under a plan. Generally, fixed liabilities are the vested benefits accrued under the plan benefit formula as of the date of plan termination, taking into account current salary and years of service. Contingent liabilities include those benefits for which the vesting requirements have not been satisfied as of the date of plan termination.

If a pension plan is terminated, plan assets must first be applied to satisfy plan liabilities. Upon the satisfaction of such liabilities, plan assets remaining in the trust related to

the plan may be distributed to the employer. The ability of an employer to recover excess assets has long been the law. During its deliberations prior to the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"), Congress rejected proposals to prevent or limit an employer's ability to recover excess assets. In fact, Title IV of ERISA specifically provides that an employer may recover excess assets if all plan liabilities have been satisfied and certain conditions are satisfied.

Excess assets may arise upon termination of a defined benefit plan because of changes in interest rates and investment performance and because of the actuarial nature of plan funding. In determining the amount of contributions that may be made to a plan, an actuary makes certain assumptions regarding the rate of return on plan investments, salary increases until participants' projected retirements, the rate of employee turnover and mortality and other factors, which may prove to be untrue. Moreover, these assumptions are made on the basis of an ongoing plan. Thus, the anticipated expense of benefits that the actuary projects to be earned by participants is not incurred when a plan is terminated. Furthermore, the funding methods that may be used for budgeting the cost of projected benefits generally require minimum contributions that exceed the accrued benefits under the plan. For example, if a level funding method is adopted by an employer, the employer makes contributions to the plan over the working lives of its employees in such a manner that the employer may avoid large increases in annual costs. An employer contributing to a plan under a level funding method typically contributes more in each of the plan's early years than the value of the benefits earned in each such year. In sum, when a plan is terminated, excess assets may exist because (i) the actual experience of the plan may be different from the assumptions made by the actuary, (ii) the accrued benefits, both fixed and contingent, are less than those projected to be earned upon participants' retirements, and (iii) the funding method adopted by the employer generally would have required prefunding of those projected benefits.

Treasury regulations published prior to the enactment of ERISA provide that an employer may reserve the right to receive any excess assets if they are due to erroneous actuarial computations. Excess assets are due to erroneous actuarial computations if the liabilities under the plan upon its termination are less than the projected plan liabilities determined by a competent actuary using reasonable assumptions. If any excess assets are the result of decreases in benefits earned under plan or changes to vesting requirements for such benefits, the assets are not considered attributable to erroneous actuarial computations. Thus, excess assets due to such amendments may not be distributed to an employer. The only other constraint on reversions of excess assets is the requirement that excess assets attributable to employee contributions be returned to participants.

Recent Legislation

The concept of excess assets attributable to erroneous actuarial computations as set forth in the regulations has not been changed over the years. In fact, Congress has reaffirmed an employer's right to recover excess assets upon plan termination several times during its deliberations of recent tax bills.

Congress recognized this right in the Tax Reform Act of 1986 ("TRA '86") when it imposed a 10% nondeductible excise tax upon reversions received by employers. See Senate Report No. 99-313. The Conference Committee Report to the Pension Protection Act (Omnibus Budget Reconciliation Act of 1987 (OBRA '87), Title IX, Part II) states that present law permits an employer to recover excess assets if such excess is due to actuarial error and to the extent such excess is not attributable to employee contributions. The Senate Finance Committee Report relating to the Pension Protection Act states that the terms of the plan document determine whether an employer has the right to recover excess plan assets or is required to share the excess assets with plan participants. The Report concludes that present law standards regarding reversions and the 10% excise tax on reversions are the appropriate rules for addressing the issue of employer access to excess plan assets. The Technical and Miscellaneous Revenue Act of 1988 increased the excise tax from 10% to 15%.

The Pension Protection Act affected reversions in two ways. First, the Act imposed an additional limit on deductible contributions to a defined benefit plan. Under this limit, an employer may not deduct contributions to the extent they result in plan assets exceeding 150% of a plan's current liabilities. Current liabilities are those fixed and contingent liabilities that must be satisfied upon plan termination. Since this limit on deductible contributions is based on liabilities earned to date, an employer's ability to contribute on a deductible basis to a plan based on benefits to be provided upon employees' projected retirement may be curtailed significantly. Moreover, because this limitation restricts an employer's ability to prefund its future liabilities under a level funding method, the amount of excess assets upon plan terminations occurring in the future will be reduced.

Second, Congress amended Title IV of ERISA to provide that any plan amendment providing for a reversion or increasing the amount of the reversion is not effective for five years. If a plan is terminated within the five year period following an amendment to permit a reversion, the excess assets must be distributed to participants and their beneficiaries. This provision was intended to prevent an employer from amending its plan prior to termination to obtain a reversion.

Treasury Department Position Regarding Reversions

The Treasury Department believes that current law correctly permits an employer to recover excess assets upon plan termination. If reversions were precluded and an employer followed a prudent method of funding on a level basis for projected benefits, the employer's actual cost could increase significantly on plan termination beyond the effect of vesting upon termination because the employer would be obligated to provide employees with larger benefits than earned under the plan. Such a result is inappropriate when the employer is assuming the ultimate risk for funding the plan. Moreover, the incentive of an employer to fund a plan adequately and to cause its investment earnings to be maximized would be decreased by a rule requiring that excess assets be used to fund extra benefits for its employees.

In a letter to Senator Byrd dated June 29, 1988, former Secretary of Treasury James A. Baker III and former Secretary of Labor Ann McLaughlin urged Congress to delete a provision from the Labor-HHS-Education Appropriations Bill requiring a moratorium on asset reversions. Secretaries Baker and McLaughlin stated that the moratorium was intended to force Congress to reconsider legislation requiring employers who terminate overfunded plans to pay greater benefits to participants than were promised. The Secretaries pointed out that this proposal was opposed by the Reagan Administration and rejected by Congress during consideration of OBRA '87. The letter warned that such legislation would deter sound pension funding, decrease employees' retirement income security, discourage employers from establishing and maintaining defined benefit plans and pose serious risks to the Pension Benefit Guaranty Corporation's financial security. The Treasury Department continues to adhere to the policy position stated in the June 29, 1988 letter of former Secretaries Baker and McLaughlin.

Current law strikes a delicate balance among the various goals of pension policy, i.e., to protect employees' retirement income security, to encourage the sound funding of plans and to encourage employers to establish and maintain pension plans for their employees. We believe it is premature to take additional steps restricting an employer's ability to recover excess assets; the effects of the recent tax law changes cannot yet be determined. The 10% nondeductible excise tax on reversions was enacted to recapture the tax benefit received by an employer recovering plan assets that were not used to provide retirement benefits to plan participants. This tax was increased to 15% only a few months ago. The new limitations on deductible contributions have only been effective for one year and, in fact, not all employers have made contributions under the new limitation. Finally, the limitation on plan amendments to increase reversions was also recently enacted.

Sound public policy should encourage the optimal funding of defined benefit plans. Any further restrictions on an employer's ability to fund its plan or recover excess assets due to the prior funding of its plan may jeopardize the sound funding of defined benefit plans. Promoting the sound funding of plans is the most desirable way to ensure employees' retirement income security under a voluntary, private pension system.

This concludes my prepared remarks. I would be pleased to respond to your questions.

Senator METZENBAUM. Mr. Trier, one thing I have not heard you say is when we agreed upon this—came to an agreement in order to permit you to get particular legislation. In the last Congress, Treasury Department absolutely agreed to review the problem of employer terminations and reversions in October of 1988. Your testimony never even refers to that agreement. What has Treasury done so far, and since we are almost at the eleventh hour of the May 1st deadline, how do you intend to live up to that agreement, or is your agreement that you do nothing?

Mr. TRIER. I do not think it is fair to say that it is our agreement to do nothing. I believe that durir the last several months this among a number of issues has been considered. It is certainly being considered in the last several weeks in connection with this testimony. And it will continue to be considered. I think that this alone with seven or eight issues, this being terminations to my mind not just reversions, but the whole issue of terminations are issues that we intend to continue to seriously consider as a response for employee benefits—people responsible for employee benefits issues in the Administration.

One of the things we have considered, of course, is whether we think an all-out comprehensive attempt to reconsider the policy and implement policy changes at this point, given the data that has come in and given our experience discussing working on various of the issues is warranted at this time, although I cannot say that we have in the last several months comprehensively treated this subject in an effort to come up with more solutions.

Of course, we have continued to consider it. I personally do not believe that we should be at this point after benefits legislation that has been enacted almost every year since at least 1982, and we should see how the system works for a period of time before beginning a new onslaught with respect to a large question like this.

Senator METZENBAUM. You say you want to begin to see how it works. It has not been working. The Treasury Department agreed to try to come up with some new solutions in connection with this, at least agreed to do something about it. What I hear you saying is: maintain the status quo. What have you come up with since October besides doing nothing new?

Mr. TRIER. I do not consider the agreement last year to be an agreement to come up with something to change the status quo. I consider it to be an agreement to continue to study the issue in an informed way.

Senator METZENBAUM. I want to tell you, I do not know when I have heard more disappointing testimony than I have from you today, Mr. Trier.

I am very happy to welcome a new ranking member of this Subcommittee, a member of the United States Senate, but one who has had a very distinguished record and a very able Member of the House of Representatives. I am happy to have Senator Jeffords with us today. Senator Jeffords, do you care to make an opening statement or have any questions of Mr. Trier?

Senator JEFFORDS. Mr. Chairman, thank you very much. I have a brief opening statement which I will put in the record at this point.

Senator METZENBAUM. Without objection, to be included.

OPENING STATEMENT OF SENATOR JEFFORDS

Senator JEFFORDS. What I would just like to say very briefly that there is no more important area in my mind that our subcommittee will be looking into than the question of pensions. And we have dealt with underfunded pension plans, more specifically and articulately in the last few years, but equally difficult and also important are the questions of the overfunded which we are talking about today and I look forward to the testimony. I do not have any particular question at this time. You had some good questions and I will just go forward.

Senator METZENBAUM. Thank you very much, Mr. Jeffords. Mr. Walker, we are happy to hear from you, sir.

STATEMENT OF HON. DAVID M. WALKER, ASSISTANT SECRETARY, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR, WASHINGTON, DC

Mr. WALKER. Thank you, Mr. Chairman. Let me apologize at the outset for my voice. It seems that I have caught the President's cold which is very fashionable nowadays.

Senator METZENBAUM. If you say the right thing, Mr. Walker, we will not be critical. If you say the wrong thing, we will take issue with your voice.

Mr. WALKER. Mr. Chairman and Senator Jeffords, it is a pleasure to be before you here this morning to talk about this important subject matter. I do have a full written statement that I would like included.

Senator METZENBAUM. Without objection. Your entire statement will be included in the record, as well as Mr. Trier's.

Mr. WALKER. Thank you, Mr. Chairman. Therefore, what I would like to do is to summarize certain parts of my testimony for you and Senator Jeffords and for the subcommittee.

The first portion of my written testimony represents an overview of ERISA and its application to the termination of defined benefit pension plans, followed by a brief review of pension plan terminations and asset reversion trends during this past decade. Since this is largely background material again, I would like to focus more on recent legislative developments in this area, as well as the department's current views with regard to these matters, if I might.

It is the department's view that while the decision to terminate a pension plan is a settlor function outside of the scope of the fiduciary provisions of ERISA, the rights of plan participants and beneficiaries must be carefully safeguarded when employers seek to recover pension fund assets from "overfunded" pension plans. The Department of Labor continues to be concerned about the consequences of terminations—termination activity. It is important to note, however, that a number of actions, as you know, Mr. Chairman, have been taken in this area over the past several years.

For example, on May 23, 1984, the Department of Labor together with the Internal Revenue Service and the Pension Benefit Guaranty Corporation issued the so-called Administration Joint Implementation Guidelines relating to the termination of defined benefit plans in which residual plan assets revert to sponsors. These guidelines were designed to protect the interest of plan participants and

beneficiaries, to encourage the continuation of defined benefit pension plans and to clearly define the responsibilities of plan sponsors when they terminate a plan. Under the guidelines as you know, all participants must be fully vested in their accrued benefits. Annuities must be purchased to provide those benefits and to protect them against market downturns and a portion of any residual assets which might be attributable to contributions that the individual employees might have made to that plan must be allocated to participants.

In an effort to address much broader pension policy issues than could be accommodated within the context of current law which is what the guidelines were all about—within the context of current law, the Reagan Administration, as you know developed a comprehensive proposal dealing with both underfunded and overfunded defined benefit pension plans. This proposal was submitted to the Congress in February of 1987.

And as you know the Congress subsequently enacted the Pension Protection Act of 1987 which while it dealt primarily with underfunded pension plans as Senator Jeffords noted earlier, it did contain several provisions relating to overfunded pension plans which were supported by the Reagan Administration. For example, as was referred to earlier in the Washington Star situation, if you will. Previously plan sponsors could add a provision to a plan authorizing a reversion of residual assets to the employer immediately prior to the plan termination which is what happened in the Washington Star case which is troubling to all parties concerned.

Now after the Pension Protection Act, a five-year waiting period is required before a plan amendment permitting a reversion becomes effective. The Pension Protection Act, also included amendments providing for a more reasonable rate of return to be paid to participants when they made any contributions to the pension plan. It is only fair that if they contributed to the plan, they ought to receive a reasonable rate of return for their share of any excess assets that might be in the plan upon termination.

In addition, the Technical and Miscellaneous Revenue Act of 1988 increased the excise tax applicable to reversions of residual assets from 10 to 15 percent. We think that public policy makers must focus on the benefits of changing the law further. That restrictions on reversions must not discourage sound funding of pension obligations because we think that this would possibly be a step back in our mutually shared goal of assuring the security, the stability, and the credibility of the private pension system. And we think it is important to examine the changes in recent law before we move precipitously.

I think it is important to note that due to the change in economic circumstances and because of the aforementioned Congressional actions which you all were involved with—obviously, you passed, termination reversion activity has declined significantly since its peak in 1985. Specifically, according to statistics that were provided to me yesterday by the Pension Benefit Guaranty Corporation, the number of large reversion cases and the amount of assets reverting to employers has declined by 71 percent since its peak in 1985. It appears that the imposition of the excise tax on reversions which was initially 10 percent, as you know, and was subsequently raised

to 15 percent, has resulted in a significant disincentive to terminations in addition to assuring that the Treasury is protected against tax abuse.

And I think it is important to note that most sponsors do not want to terminate their pension plans for a number of reasons, and in fact, most have not. Because at present there is over $250 billion in so-called surplus assets in these pension plans and a vast majority of sponsors, the overwhelming majority have not sought to engage in such transactions, and there is good reason not to.

The Department does, however, have a number of continuing concerns regarding this issue. First, we are dedicated to assuring that employers fully comply with current law related to asset reversions and in this regard, we have brought several pieces of litigation when we have felt that ERISA has been violated.

Second, we acknowledge that there are at least two fundamental provisions underlying ERISA. First, to establish rules which provide for pension benefit security to participants and beneficiaries; and secondly, to provide pension benefit security within the framework of a voluntary private pension system. And there are tensions and tradeoffs in that situation. As a result we believe that it makes sense to explore approaches that, among other things, are designed to provide reasonable alternatives to plan termination and that will assure that ongoing funds are funded adequately which is critical, because if we try to proceed with an approach that does not meet that objective, then in the long term that will serve to undermine benefit security which is not in any of our——

Senator METZENBAUM. When you say ongoing funds are adequately secured financially; are you also implying that there should be, or consideration should be given, to possible adjustments for inflation over the years? Does Labor think that that is one of the concerns that ought to be involved?

Mr. WALKER. When I talk about the ongoing plans being funded adequately, I think the context that was intended here, Mr. Chairman, is that to the extent that you take actions in this area, when you are dealing with terminations of overfunded pension plans, the particular actions that you take are important. It is important to analyze the likely effects of those actions. Obviously we want to make sure that these plans are funded adequately so that the benefit security is not compromised. And it is important in assessing any potential actions here, including what you are talking about here as to what the effect might be on the willingness of employers to offer these plans, to maintain these plans, or to put enough money in them in the future to make sure that benefit security will not be compromised and the PBGC will not be exposed to losses.

Senator METZENBAUM. Inflationary adjustments can be a part of the consideration in the funding?

Mr. WALKER. Candidly, I think that one of the issues that has been raised is the issue of cost of living adjustments which I think is what you are referring to now. I think it is important to note that within the context of current law, to the extent that a pension plan has, as part of the plan document, which some do, but you and I both know that most do not. To the extent that they have as part of the plan document, that participants are entitled to a cost

of living adjustment, then those must be provided for. They have to be provided for when a plan is terminated. You cannot back away from that, it would be a violation of the Internal Revenue Code and of ERISA.

The question is, is to the extent that a plan does not provide expressly for that provision. And to the extent that the employer might have in the past or may in the future be willing to grant so-called ad hoc cost of living adjustments to retirees, how should that be handled? The past Administration, as you know, had proposed a number of suggestions with regard to overfunded pension plans that would have assured that there would have been a cushion of assets in the plan that would have increased the possibility or the probability, if you will, that these types of adjustments would be offered in the future. It tried to go with alternatives to termination because one of our problems that we have right now, Mr. Chairman, is that because of favorable investment performance and a number of other positive economic developments, et cetera, there has been huge surpluses built up in a number of these plans and the only way that employers can obtain the economic benefit of that surplus, short of reducing their contributions over future years, which may take quite a bit of time, given the average funding of some of these plans, is to terminate.

And that is really unfortunate because even if participants are fully protected, and, in fact, they do have to be fully vested in their benefits, annuities have to be purchased. They have to receive any portion of surplus that might be applicable to their contributions. Even if they are fully protected, even if they are covered by a defined benefit pension plan that gets full past service credit, and they do not lose anything, a dime. Seventy percent of the terminations that have occurred are in that category over the past.

There is a perception problem. There is a concern with regard to stability in the credit system because the employer has to go through the termination. So I think, Mr. Chairman, that one would have to be very cautious about looking into that area because it could serve to discourage the willingness of employers to create or maintain these plans or to properly fund them.

Senator METZENBAUM. Why would it discourage any employer from setting up such a plan since there is nothing obligatory or mandatory or even inferentially requiring the employer to make cost of living adjustments? Even those of us who feel most strongly about the right of the employees or the retired workers to get some adjustment have never proposed anything along the line of making it mandatory, except when there is this extra pot of money. At least then the employer has a chance to consider cost of living adjustments. When you take the entire surplus out, it is goodbye Charlie—that is the end of the game. And certainly we never attempt to affect pension security in saying you make a cost of living adjustment, and at the same time jeopardize the security of the fund. Nobody has ever advocated anything of that kind.

What we are concerned about is the fact that even since 1985, Mr. Walker, $7 billion in reversions have been taken out. There has been some slowdown, it is true, but the fact is, there is still something like $250 billion in excess of funds that are still avail-

able. And I might ask Mr. Trier, how much is pending waiting the May 1st hold back?

Mr. TRIER. Based on the reports of the various regional offices, there were 174 letter requests processed awaiting May 1, 1989, to release the letters, which means they have gone through the entire process. The dollar amount of the reversions in those cases, we have it at roughly $150 million. There are an additional 488 letters that are being processed. You know, you have not gotten to the end of the process yet. And it is also important to note, that as we are trying to get a handle on the termination phenomenon, of the first 174, 48 are 401(a)(26) cases—401(a)(26) was the 1986 Act that required that pension plans cover a certain number of employees—50 or 40 percent.

And primarily those plans are plans that covered partners in a law firm, each partner in a law firm. And 48 of the 174 are those. And of the 488 that are being processed, 219 are of that type. So the remainder are normal corporate terminations.

Senator METZENBAUM. How much would be involved totally if all of them were to be terminated?

Mr. TRIER. We do not have the figure unfortunately on the ones that are in process. Of the 174 that are ready to go, as I mentioned, it is $150 million in reversions.

Mr. WALKER. Mr. Chairman, anticipating that you might ask that question, I yesterday received from the Pension Benefit Guaranty Corporation the number of termination cases that were pending as of 12/31/88. For major cases, those being defined as where there is a reversion of one million or more which is really the ones where you are talking about most of the money, most of the participants—there are 29 involving about $118 million which is at or near an historical low as far as pending activity.

Senator METZENBAUM. Okay, complete what you were saying.

Mr. WALKER. Thank you, Mr. Chairman. We are well aware that the asset reversion issue has been controversial, and that there had been a diversity of views regarding whether and how it should be addressed. Some have advocated making employers liable at plan termination for projected pension benefits, rather than those that accrued up to date of plan termination. Others have insisted that restrictions on asset reversions should only be considered within the context of substantially stricter funding rules. Proposals have been circulated to share a portion of the residual assets with plan participants to provide cost of living adjustments, as we were just talking about for retirees, or to permit employers to use residual assets to fund retiree health benefits, a large and growing problem.

It is clear from the enormous diversity of views on this subject that all interested parties must work together in a constructive and cooperative manner in order for any further progress to be made. This will require, among other things, a good working relationship between Congress and this new Administration. We may not always agree that legislation is necessary, or on particular approaches, but we must have a constructive and bipartisan working relationship with this committee and the Congress.

In conclusion, the issue of plan terminations involving asset reversions to employers is an important, complex and long-standing issue. We are briefing Secretary Dole with respect to its develop-

ments and legislative history, as well as to the continuing interests of this committee and other interested parties to make sure that she is fully informed on this matter.

The Department of Labor is dedicated to ensuring the credibility, integrity and security of our voluntary private pension system. We recognize that pension plans are not only important as a means of assuring retirement security by supplementing Social Security to assure a decent standard of living during their retirement years, but that the assets in these plans also represent the largest form of private savings in our economy and an important pool of capital to fuel our Nation's continued economic growth. As a result, we feel that issues affecting private pension plans, including this very important and controversial issue, must be considered with care in order to assure real progress while avoiding counterproductive approaches.

Accordingly, we are and always will be available to you as a source of technical assistance and the committee, as well as to represent the Administration's views. This concludes my remarks. Mr. Chairman, I will be happy to answer any questions you may have, and again it has been a pleasure to have an opportunity to come back up and talk to you about this issue.

[The prepared statement of Mr. Walker follows:]

STATEMENT OF DAVID M. WALKER, CPA
ASSISTANT SECRETARY OF LABOR FOR PENSION AND WELFARE BENEFITS
U.S. DEPARTMENT OF LABOR
BEFORE THE
SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

February 9, 1989

I. INTRODUCTION:

Mr. Chairman and Members of the Subcommittee, my name is David M. Walker; I am the Assistant Secretary of Labor for Pension and Welfare Benefits.

I am pleased to appear before you today to discuss the views of the Department of Labor with respect to defined benefit pension plan terminations which result in a "reversion" of residual plan assets to a plan sponsor. Before I address the specific questions you have directed to me, however, I would like to take a moment to concisely describe current law with respect to the regulation of pension plans terminated under such circumstances.

II. OVERVIEW OF ERISA AND ITS APPLICATION TO THE TERMINATION OF DEFINED BENEFIT PENSION PLANS:

The Secretary of Labor is generally responsible for the administration and enforcement of Title I of the Employee Retirement Income Security Act of 1974 (ERISA), including the fiduciary standards of conduct, prohibited transaction provisions, and reporting and disclosure requirements. This

authority has been delegated to the Pension and Welfare Benefits Administration (PWBA). The Secretary of Labor also chairs the Board of Directors of the Pension Benefit Guaranty Corporation (PBGC), the government corporation that administers Title IV of ERISA.

Two principal types of pension plans are regulated by ERISA: first, defined contribution plans, where a plan sponsor promises and has a legal obligation (in accordance with the plan's provisions) to make certain contributions to the plan which, along with earnings and losses, are allocated to the plan participants' individual accounts; and second, defined benefit plans, where a plan sponsor creates a plan which provides a specified benefit to each participant at his or her retirement, and the plan sponsor promises and is legally obligated to fund the plan in such manner as to reasonably assure that assets will be available in the plan to pay benefits accrued over time by the participants under the plan's benefit formula. The activity we are discussing today results from the termination of certain defined benefit pension plans.

An ongoing pension plan's assets are placed in and belong to a separate trust which is established for the purpose of providing retirement income. In defined benefit plans, benefits generally accrue over the working life of a participant according to a formula designated in the plan. When a participant becomes vested under such a plan, he or she becomes entitled to a nonforfeitable benefit which is generally payable at retirement.

The plan's legal obligation to pay accrued benefits is independent of the amount of assets in the trust. Assets contributed by the plan sponsor to the plan are not allocated to each participant's individual account balance, but are placed in a general trust for the purpose of funding the plan's legal obligation to pay future benefits. Generally, if there are insufficient assets to pay promised benefits when a plan is terminated, the plan sponsor must make up the difference. If the plan has more than sufficient assets to pay promised benefits at termination, any residual assets may revert to the plan sponsor if the plan provides for such reversion and certain other conditions are met. Thus, in defined benefit plans vested participants are entitled to a specific benefit, not to a specific portion of the trust assets.

I would like to focus attention, for a moment, on ERISA's fiduciary standards and how they relate to the decision to terminate a plan which has more than sufficient assets to pay accrued benefits.

Section 403(c)(1) of ERISA generally requires that, except as provided in the plan termination provisions of Title IV of ERISA, the assets of the plan shall never inure to the benefit of any employer. They must be held for the exclusive purposes of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan.

Under section 404 of ERISA, a fiduciary must discharge his or her duties solely in the interests of plan participants and beneficiaries, for the exclusive purpose of providing benefits to participants and beneficiaries. These duties must be carried out with the care, skill, prudence and diligence that a prudent man would use. The fiduciary must exercise his or her responsibilities in accordance with the documents and instruments governing the plan insofar as those documents and instruments are consistent with the provisions of ERISA.

Section 406 of ERISA describes a variety of "prohibited transactions" -- particular transactions with persons such as plan fiduciaries, plan sponsors and plan service providers who are called "parties-in-interest" to the plan. These transactions are per se prohibited, in the absence of a statutory or administrative exemption, so as to protect the plan from abuse.

The above three provisions, taken together, serve as the basis of ERISA's protection of the assets of an ongoing pension plan from abuse by plan sponsors.

In determining whether sections 403, 404 and 406 apply to the decision of a plan sponsor to terminate a pension plan, one has to recognize that our private pension system is a voluntary one. The decision to adopt, terminate or amend a pension plan is a business decision, not a fiduciary decision.

In recognition of the voluntary nature of the private pension system, the Department has identified a class of actions relating to plans that are not fiduciary in nature, even though

they may have a significant impact on plan participants and beneficiaries. These so-called "settlor" or plan sponsor functions include decisions relating to the establishment, termination, and design of plans -- rather than the management of ongoing plans. Transactions undertaken to implement the decision to terminate a plan, however, are generally fiduciary activities subject to the fiduciary duty provisions of ERISA; such transactions include the payment of full accrued benefits, the purchase of annuity contracts, and the equitable distribution to qualifying participants and beneficiaries of any remaining assets attributable to participant contributions. The performance of these functions will have an effect on the amount of residual assets that may revert to the plan sponsor.

In the case of terminations where there are more than sufficient assets to meet plan benefit obligations, Title IV of ERISA provides that residual plan assets may revert to the plan sponsor if three specific conditions are met. Those conditions, contained in ERISA section 4044(d)(1), are: first, all liabilities of the plan to participants and their beneficiaries have been satisfied; second, the distribution of residual assets to the plan sponsor does not contravene any other provision of law; and third, the plan contains a provision expressly authorizing such distribution to the plan sponsor under such circumstances. Once a plan termination has been properly implemented, residual assets returned to the plan sponsor are not subject to further ERISA regulation.

III. PENSION PLAN TERMINATION AND ASSET REVERSION TRENDS DURING THIS DECADE:

It is important to keep the reversion activity in perspective. Most plan sponsors do not want to terminate their "overfunded" plans. It should be noted that only a small minority of all plan sponsors have engaged in such activities, and of those that have, most have established new defined benefit plans providing their employees with the same or better benefits as the terminated plans. In these cases workers do not lose.

The increase in pension fund asset reversions earlier in this decade can be attributed to a unique confluence of events. For example, historically high interest (settlement) rates, coupled with the unprecedented rise in stock prices in the first part of the 1980s, combined to substantially lower plan liabilities and increase plan assets simultaneously. Many conservatively managed plans that were already well-funded experienced tremendous gains during this period. As a result, many plan sponsors discovered that their plans had far more assets than were necessary to meet their accrued liabilities.

Circumstances have changed, however; and as a result, reversion activity has declined significantly since 1985. The imposition of a 10 percent excise tax on asset reversions contained in the Tax Reform Act of 1986, subsequently increased to 15 percent this past year, has created additional disincentives to such terminations.

IV. DEVELOPMENT OF PAST LEGISLATIVE RESPONSES:

It is the Department's view that while the decision to terminate a pension plan is a settlor function outside of the scope of ERISA, the rights of plan participants and beneficiaries must be carefully safeguarded when employers seek to recover pension fund assets from "overfunded" pension plans. The Department of Labor continues to be concerned about the consequences of termination activity.

On May 23, 1984, the Department of Labor, together with the Internal Revenue Service and the Pension Benefit Guaranty Corporation, issued joint Implementation Guidelines regarding the termination of defined benefit plans and the reversion of residual assets to plan sponsors. These Guidelines protect the interests of plan participants and beneficiaries, encourage the continuation of defined benefit plans, and clearly define the responsibilities of plan sponsors when terminating a plan. Under the Guidelines, all participants must be fully vested in their accrued benefits, annuities must be purchased to provide those benefits, and a portion of any residual assets attributable to any employee contributions must be allocated to participants.

In an effort to address broader pension policy issues that could not be accommodated within the context of current law, the Reagan Administration developed a comprehensive proposal dealing with both "underfunded" and "overfunded" defined benefit pension plans. This proposal was submitted to Congress in February 1987.

The Congress subsequently enacted the Pension Protection Act of 1987 (PPA) which, while it dealt primarily with "underfunded" plan issues, contained several provisions relating to "overfunded" plans which were supported by the Administration. For example, previously plan sponsors could add a provision to a plan, authorizing a reversion of residual assets to the employer, immediately prior to plan termination. A five-year waiting period is now required before a plan amendment permitting a reversion becomes effective. The PPA also included amendments providing for a more reasonable rate of return on participant contributions when benefits are calculated upon plan termination. In addition, the Technical and Miscellaneous Revenue Act of 1988 increased the excise tax applicable to a reversion of residual assets from 10 percent to 15 percent.

Public policy makers must focus on the benefits of changing the law further. Restrictions on reversions must not discourage sound funding of pension obligations -- this would be a step back from the progress made in PPA. We need to examine the effects of the recent legislation before more changes are made.

V. THE DEPARTMENT OF LABOR'S CONTINUING CONCERNS:

Two of the fundamental principles underlying ERISA are: first, to establish rules which provide pension benefit security to participants and beneficiaries; and, second, to provide benefit security within the framework of a voluntary private pension system. We believe it makes sense to explore approaches

that are designed to provide reasonable alternatives to plan termination and assure that ongoing plans are adequately funded.

In addressing the asset reversion issue, however, we must remain faithful to those two fundamental principles of ERISA -- benefit security and the voluntary nature of the private pension system. To do otherwise would only serve to discourage the creation, maintenance and adequate funding of defined benefit plans, which is not in the interest of workers, retirees or the Federal pension insurance system.

VI. CONCLUSION:

We are all aware that the asset reversion issue has been controversial, and there has been a diversity of views regarding whether or how it should be addressed. Some have advocated making employers liable at plan termination for projected pension benefits rather than only those benefits accrued up to the date of termination. Others have insisted that restrictions on asset reversions should only be considered within the context of substantially stricter funding rules. Proposals have been circulated to share a portion of residual assets with plan participants, to provide COLAs for retirees, or to permit employers to use residual assets to fund retiree health obligations.

It is clear from the enormous diversity of views on this subject that all interested parties must work together in a constructive and cooperative manner in order for any further

progress to be made. This will require, among other things, a good working relationship between Congress and the Administration. We may not always agree that legislation is necessary, or on particular approaches, but we must have a constructive and bipartisan working relationship with this Committee and the Congress.

In conclusion, the issue of plan terminations involving asset reversions to employers is an important, complex and long-standing issue. We are briefing Secretary Dole with respect to its development and legislative history, as well as the continuing interests of Committees such as yours, so she will be fully informed about this matter. The Department of Labor is dedicated to ensuring the credibility, integrity and security of our voluntary private pension system. We recognize that pension plans are not only important as a means of supplementing Social Security to assure that Americans have a decent standard of living in their retirement years, but that the assets in these plans also represent one of the largest forms of private savings and an important pool of capital to fuel our nation's continued economic growth. As a result, issues affecting private pension plans must be considered with care in order to assure real progress while avoiding counterproductive approaches. Accordingly, we are always available to you as a source of technical assistance, as well as to represent the Administration's views.

This concludes my prepared remarks. Thank you for the opportunity to testify on this issue today. I would be happy to provide any further information you may require and to answer any questions that you or other members of the Committee might have.

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Senator METZENBAUM. Thank you, Mr. Walker. As a matter of fact I think I should say that your statement sounds a little bit more like the kinder, gentler Nation than Mr. Trier's comments. So apparently we have the cold-hearted Treasury Department and the Labor Department that has heard the message from the Administration. It is interesting that the two are really quite different because you are saying, we are prepared to sit down and work; we are prepared to consider this problem. The Treasury Department said the door is slammed; the issue is behind us.

We look forward to working with you and I want to say that I think under the new Labor Secretary that there is a real intent on her part to work with the Congress in connection with a number of these problems. I know I speak for all the members of the Labor Committee when I say that nothing would please us more. We look forward to that kind of relationship.

I do have some questions, if you please. In 1987, the Reagan Administration determined that termination reversions threatened benefit security and the stability of the pension plan system. The Administration sent a legislative proposal to Congress to limit an employer's ability to get a reversion. Legislation did pass Congress, but, as you know, was deleted in conference. The 1987 proposal permitted employers to withdraw some of the money and required that a cushion be kept in the plan of 25 percent. I am frank to say that I do not think it was a good solution, but I will say that it was at least some movement in the right direction. I would hope that we could work something that would be better than that, but at least that would be a reasonable starting point.

Does the Administration still support the 1987 proposal?

Mr. WALKER. Mr. Chairman, Secretary Dole has not been fully briefed on this issue and other key members of the new Administration have not either. Clearly, the prior Administration's proposal will be something that will be considered as a possible means of looking at this issue. I think it is important to note, since I had something to do with the prior Administration's proposal, that the thrust there was to try to decrease the incentives for plan termination, but to do so in ways that would not discourage employers from creating or maintaining these plans or properly funding these plans. I think that it is important to note as well that the thrust was to improve the stability and the credibility of the system, but I do not believe that we stated or felt that the security of accrued benefits in any way are being jeopardized under current law.

Because clearly by requiring that participants accrued benefits be fully vested, by requiring that annuities be purchased from a sound insurance company to back up those, and by requiring that a portion of any so-called residual assets be allocated to any participant contributions, then benefit security with regard to the accrued benefit is there. The question is what can be done to reduce incentives for termination.

Senator METZENBAUM. Mr. Walker, assuming that you will be taking a look at that previous proposal, take a look at it and give some consideration of what would have happened if you would have permitted 75 percent withdrawal and then the stock market debacle of October, 1987, and whether or not some of those funds would have been underfunded with only a 25 percent cushion.

Mr. WALKER. Excellent point, Mr. Chairman. And we did look at that right after the stock market declined. In fact, the day after the stock market declined, I had my staff do a little bit of work on that. Because, as you know, the Pension Protection Act really was not passed until after that stock market decline. So as a result, what we found was that the 25 percent cushion would have been an adequate safeguard to assure that plans would not have been underfunded. And the reason being is because pension plans under ERISA, among other things, are required to maintain a diversified portfolio of assets. A typical pension plan only has from 40 to 50 percent of its assets in the equity market, and therefore, based upon our analysis it would have been adequate. Although I think it is fair to say in looking at that type of concept, to the extent that it is reconsidered, is that the right amount of cushion or are there other considerations that we ought to consider.

Senator METZENBAUM. Mr. Walker, I look forward to working with the Secretary and her representatives to see if we can move promptly and constructively. I intend to introduce legislation, as I indicated in my opening statement, shortly after Congress returns from recess, but I would hope that my staff would be promptly meeting with the people from the Labor Department to see if we can make some meaningful progress and maybe bring it to a conclusion by an agreed bill prior to May 1st, so that if there were any changes or if it were to have any impact that at least we would be meeting that deadline.

Senator Jeffords?

Senator JEFFORDS. Thank you, Mr. Chairman. I have tried to keep an open mind on these issues and as you know we have been debating these in conference over a couple of years. Mr. Walker, I am just curious, there seems to be a little bit of a conflict between your testimony and others on what has been happening after a termination with respect to the creation of a new defined benefit plan. I wondered if you could articulate because others seem to think that the situation is not as good as you are stating with respect to that?

Mr. WALKER. Based upon the statistics that were provided to me by the Pension Benefit Guaranty Corporation, and I can provide more accurate numbers for the record should you so desire, Senator. My recollection is that first it is important to know that in every termination, no matter what type of successor plan there might be, and no matter whether there is a successor plan, that all of the accrued benefits as of the date of plan termination must be provided for. And if a participant is not fully vested, they must become fully vested. They have got to have that annuity contract and any excess assets due to participants' contributions must be allocated to them.

On a prospective basis, based upon the data that I have been provided by PBGC which is kind of the keeper of the termination statistics, my understanding is about 70 percent of major termination reversion activities have involved a successor defined benefit plan which provides as good or better benefits than the plan that had gone through the transaction. That approximately 25 percent involve a situation where the employer has made a decision to go from a defined benefit plan to a defined contribution plan which as

you know is fundamentally different as to the nature of the promise. And so there will be additional benefits earned by participants, but in a different form. And that about 5 percent of the cases the employers have not reestablished a successor plan. But that in a vast majority of those cases, it has been a situation where they have gone out of business where there really was not an opportunity for future accruals to occur because the company was going out of business.

Senator JEFFORDS. There is considerable interest in, and certainly in my mind, retiree health benefit plans; can you give me any indication as to what has been going on after terminations with excess assets on a voluntary basis for creation or to improve retiree health benefit plans?

Mr. WALKER. I do not know that there has been any direct linkage at the present point in time between termination of overfunded pension plans and retiree health benefits. As you know, one of the concepts that was embodied in the past Administration's proposal was, in addition to trying to reduce the incentives for plan termination, there was a provision in the past proposal—actually a couple of provisions in the past Administration's proposal—that would provide incentives for employers to use a portion of any residual pension assets to fund retiree health benefits in ways that would not compromise benefit security and ways that would not threaten the PBGC or subject the Treasury to tax abuse.

Now I think our thinking has evolved on what the past Administration had proposed, but I think that the concept personally of what might be able to be done to encourage employers to use a portion of such residual assets, at least to be able to take care of current retiree health care obligations is something that I think seriously about.

Senator JEFFORDS. I am very interested in that aspect and I look forward to working with you on it. Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Jeffords. Mr. Walker, you said something about that you found that 70 percent have continued defined benefit plans?

Mr. WALKER. That is my understanding, Mr. Chairman. I will be happy to provide an exact number for you.

Senator METZENBAUM. Comparable defined benefit plans after terminations and after reversions in 1986 were 46 percent, and in 1987 went down to 36 percent, and in 1988 went down to 22.5 percent. Interestingly, at the same time, no new plans—21 percent in 1986, 26 percent in 1987, 37.5 percent in 1988. So you find no new plans going up. You find comparable defined benefit plans coming down, our source: the PBGC.

Mr. WALKER. Senator, I think it is very important that we reconcile these numbers to make sure that we are dealing with a level playing field on this, and I would like to have the opportunity to get yours and let us try to have our staffs work together to reconcile.

Senator METZENBAUM. My staff has nothing more to do than spend every minute of every day at the office working with you on the facts as well as the solution. We are looking forward to it. Thank you very much gentlemen. I appreciate your testimony, and

I will say to you, Mr. Trier, come on let us get with it, let us bring the Treasury Department along.

Our next panel is Zack Carter, President of the Industrial Union of Marine and Shipbuilding Workers of America Local 18. Mr. Carter is an employee of the Alabama Drydock and Shipbuilding Company in Mobile, Alabama; and Mr. C.W. Gilbert, a retired employee of the American Standard Company of Pittsburgh, Pennsylvania. I will point out to both Mr. Carter and to Mr. Gilbert that our rules provide for five-minute testimony and such additional time for questions as the committee sees fit.

Mr. Carter, we will be very happy to hear from you. Thanks for being with us.

STATEMENTS OF ZACK CARTER, PRESIDENT, INDUSTRIAL UNION OF MARINE AND SHIPBUILDING WORKERS OF AMERICA LOCAL 18, AND C.W. GILBERT, RETIRED EMPLOYEE OF THE AMERICAN STANDARD CO., PITTSBURGH, PA

Mr. CARTER. Mr. Chairman, members of the subcommittee, my name is Zack Carter. I am president of the Shipbuilders Union Local 18 in Mobile, Alabama. I am privileged to be here today to tell you about how our 800 workers and 770 retirees are fighting to stop a raid on our pension plan by the Alabama Dry Dock and Shipbuilding Company. I want to extend special thanks, Senator Metzenbaum, for initiating the moratorium against raids on pension surpluses. It is only this moratorium that has temporarily stayed the company's greedy hands. And now only strong legislation enacted by the Congress can permanently stop this raid.

It saddens me to see the turn that our company has taken. ADDSCO was started in the early part of the century and is part of the Mobile community. My uncle, my grandfather, and my great grandfather all worked for the company. I have been a union member for 10 years and was elected president in March of 1988 to lead this fight against the raid.

Our pension raiding story started in 1987 when ADDSCO decided to use the so-called overfunding of its salaried and union plans for corporate purposes. We learned the hard way that pension law is not on the workers' side in this country. In March 1987, the company took $4.6 million out of the salaried workers' plan. In December 1987, they threatened to shut down the union shipyard if we did not give them some of our pension surplus. Our membership launched an all-out publicity campaign and was able to stop this first attempt.

But the company did not quit. In May 1988, the company initiated negotiations that were intended to force a shutdown of the union yard. The company knew that the only way it could get access to our money was to break the contract, and if it meant shutting us down, they were prepared to do it.

Three months ago, the company succeeded in its shutdown of the union shipyard, firing 800 union workers and moving production right next door to its nonunion yard. A few weeks before the shutdown, ADDSCO shamelessly stated that if law allowed it, the company would use the "surplus" for corporate purposes such as

paying off working compensation claims brought against the company.

This is an outrage. The company wants to take union workers' pension money to pay for injuries they inflicted on us. In recent years OSHA fined this company thousands of dollars for exposing unprotected workers to asbestos and excessively loud noise.

I really do not understand why companies are allowed to take surplus money when, as far as I can see, all the money is needed to pay ongoing benefits for our members. The former union president of Local 18 who helped negotiate our plan many years ago recently told our membership that the surplus in the pension plan was meant to provide benefit increases for workers and retirees, and that is how it ought to be.

We negotiated long and hard for contributions into the fund. Our members gave up wages to buy themselves a decent retirement. All the money in the plan is meant for that purpose. The so-called surplus funds would probably not exist had ADDSCO agreed to a union proposal to provide benefit increases to our active workers and cost of living adjustments to our retirees and beneficiaries.

We requested that the "surplus" be used to raise the paltry retirement benefits for retires like Wiley "Deacon" James, a church deacon, who worked for over 30 years at ADDSCO and now receives only $100 a month in retirement benefits; and Jeanette Lister, widow of a machinist of 12 years at ADDSCO who died of lung cancer. Mrs. Lister, herself is diagnosed with cancer that may be possibly terminal. She will finally get a monthly retirement check of $71.23, but not for another year and after five years, this check will be cut in half.

We have exhausted all our resources in defending our pension plan. We have held rallies, press conferences and informational pickets for over a year. Just last month, Local 18 members, led by civil rights leaders in Mobile marched four miles from the union hall to the Senior Bowl football game. We handed out over 10,000 posters telling the community to "Just say no to Pension Raiding." The Senior Bowl president is one of ADDSCO's nine directors. Other Senior Bowl sponsors are also affiliated with ADDSCO.

Despite our efforts, the company has indicated that once the moratorium is lifted, they will move forward with their plans to get at the surplus. The union workers and retirees are determined to stop the company from getting any of the surplus. Local 18 is now asking that ADDSCO's inevitable termination occur presently so that the surplus can go to the benefit of active and retired plan members.

Senator Metzenbaum, members of the Subcommittee, we need your help. We urge you to promptly pass legislation which stops plan raiding and ensures that surplus, so-called surplus assets in the pension plans be used only for workers and retirees interests.

Thank you for this opportunity to testify.

[The prepared statement of Mr. Carter follows:]

STATEMENT

of

ZACK CARTER

before the

SENATE LABOR SUBCOMMITTEE

February 9, 1989

Mr. Chairman, Members of the Subcommittee,
My name is Zack Carter and I am President of the Industrial Union of Maritime and Shipbuilding Workers of America, Local 18, DL 4 of the International Association of Machinists in Mobile, Alabama. I am privileged to be here today to tell you about how our 800 workers and 770 retirees are fighting to stop a raid on our pension plan by the Alabama Dry Dock and Shipbuilding Company. I want to extend special thanks to Senator Metzenbaum for initiating the moratorium against raids on pension surpluses. Only this moratorium has temporarily stayed the company's greedy hands. And now only strong legislation enacted by Congress can permanently stop the raid.

It saddens me to see the turn our company has taken. ADDSCO was started in the early part of the century and is part of the Mobile community. During World War II there were over 30,000 employees. If someone hasn't worked at the Yard, they have a relative or friend who has done so. My uncle, grandfather, and great grandfather all worked for the

company. The Yard has a rich union tradition being one of the first Congress of Industrial Organizations (CIO) unions. I have been a union member for ten years and was elected president in March of 1988 to lead the fight against the raid.

Our "pension raiding" story started in 1987 when the Alabama Dry Dock and Shipbuilding Company decided to use the so-called "overfunding" of its salaried and union plans for corporate purposes. We learned the hard way that the pension law is not on the workers' side in this country. In March 1987, the company took $4.6 million out of the salaried workers plan. In December 1987, they threatened to shut down the union shipyard if we didn't give them some of our pension surplus. Our membership launched an all-out publicity campaign and was able to stop this first attempt.

But the company didn't quit. In May 1988, the company initiated negotiations intended to force a shutdown of the union yard. The company knew that the only way it could get access to our money was to break the contract, and if it meant shutting us down, they were prepared to do it.

Three months ago, the company succeeded in its shutdown of the union shipyard, firing 800 union workers and moving production right next door to its nonunion yard. A few weeks before the shutdown, ADDSCO shamelessly stated that if the law allowed it, the company would cancel the pension plan to use the "surplus" for corporate purposes such as paying off worker compensation claims brought against the company.

This is an outrage. The company wants to take union workers' pension money to pay for injuries they inflicted on us. In recent years OSHA fined the company thousands of dollars for exposing unprotected worker to asbestos and excessively loud noise.

I really don't understand why companies are allowed to take "surplus" money when, as far as I can see, all the money is needed to pay ongoing, growing benefits for our members. The former union president who helped negotiate our plan many years ago recently told our membership that the surplus in the pension plan used to fund benefit increases for workers and retirees. That's how it ought to be.

We negotiated long and hard for contributions into the Fund. Our members gave up wages to buy themselves a decent retirement. All the money in the plan is meant for that purpose. The so-called surplus funds would probably not exist had ADDSCO agreed to a union proposal to provide benefit increases to our active workers and cost of living adjustments to our retirees and beneficiaries.

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Despite our efforts, the company has indicated that once the moratorium is lifted, they will move forward with their plans to get at the surplus. The union workers and retirees are determined to stop the company from getting any of the surplus.

Senator Metzenbaum, members of the Subcommittee, we need your help. We urge you to promptly pass legislation which stops plan raiding and ensures that "surplus" assets in pension plans be used only for workers and retirees interests. Without such protection, we fear our plan

Thank you for this opportunity to testify.

Senator METZENBAUM. Thank you, Mr. Carter. Senator Jeffords has another appointment, but he did have one or two questions for Mr. Carter before he leaves.

Senator JEFFORDS. I'm just a little confused on the status wherein the business could come in and raid the union pension plan, so to speak; is that because you are in the bargaining process now on the new union contract or how did that come about?

Mr. CARTER. The plan document says that the board of directors of the company can terminate the pension plan subject to contractual obligations. Our contract is due to expire February the 11th, in two days. They have indicated in documented evidence, statements that company representatives have made to us that they do indeed intend to terminate the plan. They have the authority to do it, and the only thing that has stalled them from doing it or initiating the process is this moratorium that prohibits them from taking any of the surplus funds.

Senator JEFFORDS. Thank you very much.

Senator METZENBAUM. Mr. Carter, do you have any idea as to how much the average retiree from your company presently receives in pension benefits?

Mr. CARTER. It really varies. We have not had cost of living allowances. The plan originated in 1962 and it goes from that contract to contract which are three year contracts. Right now the active members, the average pension benefit would probably be somewhere between $160 and $200 for the average career of service which is about 20 years. Now if you go back to the previous decade like the men that worked with Deacon James, Mr. Wiley James, their average pension benefit would be around $100 a month.

Senator METZENBAUM. You say $160 to $200 a month?

Mr. CARTER. Yes, sir.

Senator METZENBAUM. Is the average pension benefit? Is that what I understood you to say?

Mr. CARTER. Yes, sir.

Senator METZENBAUM. Does anybody get $600, $800, $1,000 a month?

Mr. CARTER. No, I was looking over the actuary report just the other day and the highest that I have seen is $450 a month.

Senator METZENBAUM. What kind of wages do the employees make?

Mr. CARTER. With this current contract we have been making an average of $11 an hour, and I would like to say that the individual that is going to get about $450, he was at the yard for close to 45 years.

Senator METZENBAUM. Did I understand that the company is closing down your plant and moving its work to a nonunion plant right next door?

Mr. CARTER. Yes, Senator, they have already done that. They shut us down October 27th. There has been no union workers at the yard since then, and they are continuing production at this nonunion yard which in recent years has largely paid minimum wage to its employees. They use contract labor.

Senator METZENBAUM. Are any of the union members or workers on the pension board?

Mr. CARTER. Yes, we have three union members on the retirement board. I am one of them. Just recently I was allowed to be on the retirement board because of the office of president.

Senator METZENBAUM. How many does the company have on?

Mr. CARTER. The company has three also.

Senator METZENBAUM. How will they get the votes? Will some of the union representatives vote to permit the termination?

Mr. CARTER. The retirement board, as we understand it, does not really have the authority to terminate or not to terminate the plan. The company and the plan document, the way it was set up, has that authority. It is, I believe, section 8 of our plan. It says that the board of directors of the company can terminate the plan for any reason.

Senator METZENBAUM. The board of directors of the company?

Mr. CARTER. Yes, unfortunately that is the way that the plan was drawn up years ago. The board of directors of the company can terminate the retirement plan for any reason. And then it says, subject to contractual obligations. And as I stated earlier the contract is due to expire in just two days.

Senator METZENBAUM. I would like you to obtain a copy of that documentation that we might have it for the record and I might examine it myself?

Mr. CARTER. Yes, sir, I will.

Senator METZENBAUM. Did you or the employees have any say in the company's ability to terminate the pension plan and take the excess assets? Did they ask you your position or anything?

Mr. CARTER. They sent us a letter November 7th of last year saying that they were developing a proposal to "share the surplus." They have told us verbally that they think they are entitled to about 40 percent of it. They still have not put that percentage in writing, and I do not understand where they are coming up with that figure.

Senator METZENBAUM. Have they filed with the Government yet?

Mr. CARTER. No, but their in-house attorney, Mr. Walter Meggs, told us the other day at the grievance committee meeting that they did intend the first business day after the contract expired to send out letters to the plan members saying that they intended to terminate. And also a letter to the IRS that they intended to terminate. And I said well that is interesting, what are you going to say to the IRS vis-a-vis your intentions for the surplus? His response was that they did not think that they had to commit in regard to their intentions of the surplus. They did not have to make a commitment to the Government until after May 1.

Senator METZENBAUM. Is there an agreement in writing that they will take only 40 percent of the surplus and leave this other 60 percent?

Mr. CARTER. No, sir.

Senator METZENBAUM. It is not in writing? They had told you that?

Mr. CARTER. That is correct.

Senator METZENBAUM. Is the union represented by counsel?

Mr. CARTER. Yes, we are.

Senator METZENBAUM. What do you think is the retirement promise that the company had made to its employees?

Mr. CARTER. We believe that the promise was to provide a secure retirement through contributions that we made directly to the plan and also contributions that the company made to the plan. That we view those contributions simply as deferred wages. We could have had an increase in wages, yet we put that off so we could have secure retirement instead of having an increase in wages.

Senator METZENBAUM. How much did the employees contribute; so much an hour or was that done?

Mr. CARTER. The employees contributed about 20 cents an hour and the company contributes about 48 cents an hour on this last contract.

Senator METZENBAUM. Thank you very much, Mr. Carter. My staff is prepared to work with you and cooperate with you in any way that we can to monitor this situation.

Mr. CARTER. Thank you very much, Senator.

Senator METZENBAUM. We are very happy to have Mr. C.W. Gilbert, retired employee of the American Standard Company of Pittsburgh with us today. Mr. Gilbert, please proceed.

Mr. GILBERT. Mr. Chairman, members of the Subcommittee, my name is C.W. Gilbert, and I am a 78-year old retiree from Pittsburgh, Pennsylvania. I am greatly honored to be able to participate, even in a small way in the legislative process. I am here today to tell you about how my plan was raided, and to speak on behalf of millions of other retirees in this country whose concerns have not been heard.

I am deeply troubled that pension plans can be raided for corporate profit. What makes my situation so disturbing is that my company, American Standard, used $120 million from our plan to help finance a leveraged buyout. This means that I, and hundreds of other retirees in my company, will never again get a needed cost of living adjustment. We have been left to live on pensions worth only a small part of their original value.

Let me give you a little background. I worked 51 years, my entire working life, for the corporation where I retired as a section manager for research and development. After giving five decades to the company, I trusted I would get an adequate pension, but that was before the leverage buyout.

In early 1988, I learned that Black and Decker tried to take over the company in a hostile takeover. As I understand it to defend themselves, American Standard put away $130 million for golden parachutes, spent $30 million to try to stave off the takeover and finally merged with Louis Kelso who made a counter offer of $2.5 billion.

As all of us know, a $2.5 billion offer these days probably does not require much real money. So it does not surprise me that a month after making a deal with Kelso in March of 1988, American Standard filed to raid our plan. The timing of the event does not seem like a coincidence. $120 million may only pay a small part of the buying price, but it is up front, hard cash that does not need to be paid back.

Mr. GILBERT. After the LBO and the raid on our plan, my division was sold to an Italian company. I do not understand why or how the law permits companies to siphon pension money for corporate purposes. I often wonder if Kelso or Black and Decker could

not have gotten access to the pension money, would they have been so eager to make the deal?

I naively thought that the pension promise was forever and that the money in the fund would be used only for retirement benefits. I knew that the plan was not adjusted for inflation, but assumed that the company would voluntarily give adjustments to help preserve the purchasing power of my pension. The company has, in fact, given us two adjustments.

When I discovered the plan was, so-called overfunded, I had hoped we could get another increase to make up for the impact of inflation. But when the $120 million was raided, the company left my pension fixed at that low rate forever. Today my pension, including the two increases, buys about 54 percent of what it originally bought in 1975.

And what about the oldest retirees? For people who retired in 1970, their pension, including the two small increases, now buys about 40 percent of what it originally bought. That means that a $480 monthly pension in 1970 would now be worth less than $200 a month.

Some of the excess in the fund came about simply because the pension plan did not give us adequate increases. As a practical matter, the fund earned investment returns in current dollars and got a windfall by paying us in devalued dollars. Had the pension plan kept our pensions close to their real value, then there probably would not be surplus assets.

Federal pensions and most state pensions are indexed to inflation. I guess private pensions are not required to adjust their pensions because companies voluntarily are supposed to do the right thing. But now, with plan raiding and annuitization of retirees' benefits, companies are using the money for corporate purposes, rather than for their retirees.

I know that it is too late for me to be helped by legislation, but I am concerned about other retirees from companies like the Red Cross and ADDSCO and Mr. Carter who could still be helped. The raiding of plans has gone on too long. I hope you quickly pass legislation to put an end to this disgraceful practice. Thank you for letting me testify here today. It has been a real opportunity to represent the many people who cannot be here themselves.

[The prepared statement of Mr. Gilbert follows:]

STATEMENT

of

C.W. GILBERT

before the

Subcommittee on Labor

February 9, 1989

Mr. Chairman, Members of the Subcommittee, my name is C.W. Gilbert and I am a 78 year old retiree from Pittsburgh, Pennsylvania. I am honored to participate, even in a small way, in the legislative process. I have come to Washington today to tell you about how my plan was raided, and to speak on behalf of millions of other retirees in this country whose concerns have not been heard.

I am justifiably troubled that pension plans, set up for retirement security, can be raided for corporate profit. What makes my situation so disturbing is that my company, American Standard, used $12 million from our plan to help finance a leveraged buyout. This pension "raid" has assured that I and hundreds of other retirees in my company will never again get a needed cost of living adjustment. We have been left to live on pensions worth only a small part of their original value.

Let me give you a little background. I worked 51 years, my entire working life, for the American Standard Corporation where I retired as section manager for Research and Development (for 44 years I was a salaried employee and

another 7, I was a full-time consultant). I started in 1931 when the company was called the Union Switch and signal division of the Westinghouse Air Brake Company. In 1969, the company merged with American Standard Company, a leading manufacturer of building and industrial products. The pension program with American Standard was better than before and I trusted that I'd be well taken care of in retirement. After giving five decades with the company, I expected as much.

But that was before the Leveraged-buyout. In early 1988, I learned that Black and Decker tried to take over the company in a hostile takeover. As I understand it, to defend themselves, American Standard put away $130 million for golden parachutes, spent $30 million to try to stave off the takeover and finally merged with financier Louis Kelso who made a counter offer of $2.5 billion. From what I gather, Kelso paid Black and Decker $25 million to drop their bid.

As all of us know, a $2.5 billion offer these days probably doesn't require much real money. So, it doesn't surprise me that a month after making the deal with Kelso in March of 1988, American Standard filed to "raid" our plan. The timing of the event doesn't seem like mere coincidence. $12 million may only pay a small part of the buying price, but it's upfront, hard cash that doesn't need to be paid back. Since the LBO, and the raid on our plan, my division was sold to Ansaldo, an Italian company.

I don't understand why or how the law permits companies to siphon pension money for corporate purposes. I often

wonder if Kelso or Black and Decker couldn't have gotten access to the pension money, would they have been so eager to make the deal?

I naively thought that the pension promise was forever and that the money in the fund would be used only for retirement benefits. I recognized that the plan wasn't automatically adjusted to inflation but expected that the company would voluntarily give adjustments to help preserve the purchasing power of my pension. The company has, in fact, recognized the impact of inflation and given us two adjustments, one in 1978 and one in 1981. I and other retirees thought another one was long overdue.

When I discovered the plan was , what they call, "overfunded," I had hoped we could get another increase to make up for the impact of inflation. But when the $12 million was raided, the company left my pension fixed at that low rate forever. Today my pension, including the two increases, buys about 54% of what it originally bought in 1975. Even with low inflation, in ten years it will be worth half as much.

For older retirees, their picture is even more desperate. For those people who retired in 1970, their pension, including the two small increases, now buys about 40% of what it originally bought. A secretary I know who retired with a $480 monthly pension in 1970 now has a pension worth less than $200 a month.

One doesn't have to be a mathematician to see that some

of the so-called "surplus" in the fund came about simply because the pension plan did not give us adequate increases. As a practical matter, the fund earned investment returns in current dollars and got a windfall by paying us in devalued dollars. Had the pension plan kept our pensions close to their real value, then there probably wouldn't be surplus assets.

Federal pensions and most state pensions are indexed to inflation. I guess private pensions aren't required to adjust their pensions because companies voluntarily are supposed to do the "right thing." But now, with the advent of raiding and annuitization of retirees' benefits, companies are using the money for corporate purposes rather than for their retirees' welfare. I'm also concerned that now that I'm getting a fixed annuity, I won't have the protection of the Pension Benefit Guaranty Corporation if my insurance company should run into trouble.

I know it is too late for me to be helped by legislation. But I'm concerned about other retirees from companies like the Red Cross and ADDSCO who could still be helped. The raiding of plans has gone on too long. I hope you swiftly pass legislation to put an end to this disgraceful practice.

Senator METZENBAUM. Mr. Gilbert, thank you very much for your testimony. I think it is succinct. I think it hits the target on the head, and I think it has been very helpful to us. And I must tell you as I sat here I found it appalling when you said that it was Kelso who took the $120 million. Kelso is the man who walks with a halo around his head saying what he is doing for the workers of this country. Kelso has been in to see me, telling me about the employee democratization of America with the great Kelso plan. And I find that this same Kelso now ripped off your plan for $120 million and precluded you from getting any inflationary increases.

Just last week, I saw an article in the New York Times asking corporate America to democratize access to capital credit—that was the name of it. It was for workers so that they may earn a good living. I am frank to tell you Mr. Kelso ought to be embarrassed. Mr. Kelso if he wants to continue to wear that halo ought to return the $120 million to the fund. I think that of all the cases of this kind that I have heard about, and I have heard about all of them, this one is the ultimate. This one is Mr. Good Guy becoming Mr. Bad Guy when there is a chance to pick up $120 million. I am embarrassed for him, and I think the best way he could resolve the problem would be to give back the money that he has taken from the workers' fund.

Let me see if I have any other noncontroversial questions. Let me ask you, do you think that the company, and I mean by the company, all of its previous owners and present ones, is breaking a promise whether implied or direct to the employees of this company in precluding their getting any inflationary adjustments?

Mr. GILBERT. Yes, I do. As I said, we expected some increases and we did get two of them, one in 1978 and one in 1981, but there has been nothing since 1981. But we felt that we were long overdue and then to see this money taken away and precluding any possible chance of anything in the future. What they did was to purchase annuities and so they are fixed value.

Senator METZENBAUM. Fixed amount, no chance of ever getting an adjustment?

Mr. GILBERT. Right.

Senator METZENBAUM. Thank you very much, Mr. Gilbert. I appreciate your testimony. I appreciate your testimony, Mr. Carter. At this point, I will put in the record some letters from retirees whose plans have been terminated or threatened with termination. Some of these retirees are in the audience today and I want to acknowledge their presence. They are from the American Red Cross.

I guess when it comes to taking workers' money, there is not much line drawn between Kelso's and other corporate leaders and the American Red Cross, an organization that all of us have held in high esteem over a period of many years. I did not know of the Red Cross matter until just moments ago. Frankly, I am kind of shocked and taken aback. Thank you very much.

[The prepared letters of Warren Beecher, James B. Foley, Philip V. Gaddis, and Hildegarde J. Herfurth follow:]

February 3, 1989

Honorable Howard M. Metzenbaum
140 Senate Russell Office Building
Washington, D.C. 20510-3502

Honorable Sir:

Let me first express the sincere appreciation of our retirees for the stalwart support you have given in the service of obtaining a fair distribution of "surplus" funds when reversions from over-funded retirement plans occur. You have also given us excellent advice in previous letters - advice which was borne out by our experience.

As you will note in the attached position paper, we are pushing for retirees to receive a forward acting COLA before the sponsoring corporation could participate in the disbursement of "surplus" money from an over-funded pension plan.

As you well know, the majority of large corporations have, in the past, made ad hoc adjustments to retirees' benefits. These desperately needed adjustments have almost always come from plan "surplus" money. If the corporations are allowed to capture all the surplus remaining after a cushion for actives and taxes for the government, there is practically no possibility for such ad hoc adjustments in the future. If our position on forward-acting COLA's was to be adopted, these adjustments would continue on a regular rather than an intermittent basis. This is the rationale for our approach.

I am certain that other Federal employees, including the members of both Houses of Congress would be greatly disturbed if they faced the loss of their COLA's, so we hope they will appreciate our distress caused by the possible loss of ours.

Sincerely yours,
For the Lear Siegler, Inc. Retirees Committee,

Warren Beecher

Warren Beecher, Co-Chairman

For direct communication:
Warren Beecher
2618 Carlton, N.E.
Grand Rapids, Michigan 49505
Phone: (616) 363-1260

PENSION PLAN "SURPLUS" REVERSIONS
LEGISLATIVE PROPOSALS AND COMMENTS By
LEAR SIEGLER, INC. RETIREES COMMITTEE
(4959 KALAMAZOO, S.E. KENTWOOD, MI. 49508)

1. Under current ERISA rules, when distributions from "Surplus" funds are made to retirees and employees upon termination of an over-funded plan, the distributions are to be made in proportion to the Plan individual beneficiary's benefits. On the surface this appears to be a fair enough way to achieve a distribution. Retirement benefits were accrued according to a worker's earnings (and presumably his/her contribution to the Company's success). Therefore, any further benefits should be awarded in the same way.

Unfortunately, this formula has an unintended result. Upper management people with accrued benefits of $3000 or more per month will end up with the bulk of the available distribution, even though they have already been more than amply provided for. The large number of employees with monthly benefits of $300 or less per month, who are usually at or near the poverty level, will receive only minuscule improvements in benefits and may well be forced out of their homes and on the Welfare rolls due to inflationary dilution of benefits.

If only retirees were to be benefited by such a distribution, an award in inverse proportion to the present benefit of each individual would rectify the above situation. Since, however, present active employees who have earned small benefits because of short service time must also be included, this solution is totally impractical.

It seems to us that the solution which we believe should be advanced with all possible emphasis is as follows: Whenever a distribution is to be made which would normally involve the former procedure above, it should be distributed according to a new rule which would make such awards only in direct proportion to months of service. We feel that, since the original pension was based on a system which rewarded the beneficiaries according to their salary level as well as to their years of service, that upper management employees have been sufficiently rewarded. The new method treats all employees on an absolutely equal basis.

2. We believe strongly that the law should prevent take-over entities from deriving any benefit from the pension plans of predecessor companies except those normal for their employees when they become vested.

3. We propose that after a sufficient cushion for present active employees and a Government excise tax have been provided, that corporate sponsors are not allowed to participate until they set up a future **funded** COLA for plan beneficiaries starting simultaneously with the reversion.

We recognize that if we left COLAs indeterminate to float with inflation, the Plan sponsor would be left with an unknown and incalculable exposure. We therefore propose a cap of 5% maximum in any given year. An experienced accountant would then be able to establish the funding requirements in the same manner as for the plan proper.

With an on-going plan, this approach yields benefits not just once, and not only for retirees, but for any active employee who works long enough to earn benefits when he retires. It also has a benefit for the Plan sponsor in lower employee turnover. Employees who work in certain areas for a long enough time, not only gain valuable experience, but frequently specialized knowledge, which makes them very attractive to "head hunters" for competing corporations. By this time they are likely vested in their employer's pension plan and would have second thoughts about leaving a COLA plan for one without this feature.

4. There must be a requirement that when a plan sponsor receives a reversion from surplus, he must either maintain an on-going plan or simultaneously institute another plan with all features equivalent or better than the former plan, unless he can show that this course of action would cause him to face bankruptcy.

February 9, 1989

The Honorable Howard Metzenbaum
Chairman
Senate Labor Subcommittee
140 Senate Russell Office Building
Washington, D.C. 20510

Dear Senator Metzenbaum:

We cannot tell you how grateful we are that the Labor Subcommittee is holding hearings today on the issue of reversions. We are thankful to you for taking the lead in trying to stop this disgraceful practice, and for instituting the Treasury moratorium that has temporarily protected us. If legislation is not passed soon, we will be victims of another pension heist.

We are a group of former staff of the American Red Cross who collectively have over 100 years of service with the organization. We speak not only for ourselves but for hundreds of other retirees who asked that we represent them. We stayed with the Red Cross for so many years because we believed in its humanitarian principles. Some of us and other retirees still volunteer for the organization.

It is appalling to us that the new management, recruited largely from outside the organization, has unabashedly announced its decision to plunder the pension plan of $400 million dollars. We have come to expect such shoddy behavior from fast-talking Wall street takeover artists, but we never anticipated such a self-serving strategy from the nation's foremost charitable, federally-chartered organization.

This not only stains the Red Cross' solid reputation, it is a slap in the face to all the dedicated men and women who have selflessly devoted years of service. Staff, hired at salaries far below the national average, nevertheless, served domestically and abroad in times of war and peace. We were at the sides of our armed fores and their families at home; we tended to victims of disasters and served at blood centers across the country. We believed in the humanitarian principles of Red Cross and that public service was a great and honorable calling. We still hold firm to that belief.

Meanwhile the management of Red Cross has mounted an unprecedented in-house media campaign to sanitize and sanctify their raid on the plan. A glossy news release claims that the restructuring of the plan will benefit workers and retirees, and that a part of the "surplus" will

be used for unspecified humanitarian purposes. The release also says the surplus will be used to partially defray the costs of retiree medical insurance and to give additional ad hoc adjustments to retirees.

On the surface, all of this sounds impressive. But when we analyze what's really being offered, it adds up to little protection. Let's start with the cost of living adjustments. In exchange for taking hundreds of millions of dollars of surplus assets, the management is only giving a one-time 4% across the board increase to its retirees, after which a meager 1% increase will be built into our annuities.

This small increase is the least the Red Cross can do for its retirees living on abysmally low pensions, a reflection of the low salaries earned by most of the employees combined with the fact that our pensions are not automatically indexed to inflation. Of the 5716 retirees, the average pension amount is $422 a month. The 4% increase this year, adding about $16.00 to the typical pension, would not even protect against current inflation rates, let alone making up for the past ravages of inflation. For those people receiving pensions of less than $50 a month, the increase would amount to a whopping $2.00 a month.

Now take a look at our expenses. Each of us must pay pay anywhere from $60 - $120 a month in health insurance costs that are on the rise. We have homes and apartments with maintenance costs. A few dollars a month increase in no way restores the purchasing power of our pensions.

Retirees and Red Cross staff asked that a portion of the surplus assets be used to shore up the crumbling value of the dollar. We pointed out that much of the "surplus" was created by the pay-out of devalued dollars to retirees.

The management ignored our requests and went ahead with the raid. In an attempt to mollify retirees, the management has suggested that a portion of the surplus be used to help fund health benefits. The reality is that this health care "promise" is vague and precarious. We've been given no numbers, or told how much surplus will be used for this purpose, or which retirees would be protected. As a practical matter, the leadership could, at any point, divert the surplus for organizational purposes.

So, when you get to the bottom line, we are losing our well-funded pension plan with ample monies available for cost of living adjustments in exchange for meager increases annually and a few vague promises. The management will take millions of dollars of assets and the organization will not have to make contributions into the fund for the next ten years.

We know that current management rationalizes that they are doing a whole lot better than other commercial and industrial organizations. They keep referring to the legality of their pension raid position. But its morality is never considered.

We say, no deal. There's no such thing as responsible robbery Our pension money is meant to be used solely for pension purposes. As recent as Spring of 1986, Richard Schubert, the president and CEO of the organization, was quoted in our retiree newsletter (attached) as saying that he would never take out the surplus. He recognized then that it was inappropriate for an organization such as Red Cross to consider such an action.

It's a sad comment that avarice would prevail. Three years later we find ourselves faced with a proposed annuity and no guarantees that our benefits will be paid should the insurance company have financial difficulties.

It is particularly irksome that current management never even bothered to consult us. All of this planning took place without the consultation or approval of the Board of Trustees of the retirement system, or any national, regional or local retiree groups.

Red Cross retirees in every state are beginning to unite behind a campaign to stop the planned raid on the fund. The Atlanta, Georgia chapter recently passed a resolution for the Board opposing the raid on the fund and we anticipate other chapters following suit.

We implore you to swiftly pass legislation that will stop this practice. If this does not occur before May 1, we would urge you to extend the moratorium until such legislation is passed.

We thank you again for your important leadership role.

Respectfully,

James B. Foley
Vice President (Ret.)

Hildegarde J. Herfurth
Asst. Director (Ret.)
Public Affairs

Philip V. Gaddis
Associate, Media Relations (ret.)

R. Some time ago, the employer contribution rate was reduced from 7.83 percent to 6.75 percent. In December of last year it was reduced to 5.5 percent. Now, for the period March through June, the employer contribution has been completely eliminated. Retirees understand the short-term benefits of this action for participating employers. But doesn't it set a precedent for additional, permanent reductions?

S. I think that what is likely to happen, as a practical matter, is that the Human Resources Committee of the Board of Governors will review the recommendation of its predecessor ad hoc group, which suggested that the rate of contributions should be reduced in line with actuarial assumptions.

But currently the Retirement System is approximately 185 percent overfunded.* Some Board of Governors members may well say that if we just come down in line with the actuarial rate, it will take decades for funds to be at the level it ought to be. In retrospect, we can see that the funding level was greater than it should have been. That, plus good investment experience and good management, has led to the overfunding by some $300 million.

R. Regarding that $300 million, who does it belong to? Specifically, do you believe these funds are at the disposal of the Board of Governors to use in whatever way they see fit? Or do you feel that these funds were accrued from contributions made specifically for providing retirement benefits and therefore should be used only as retirement benefits?

S. The disposition of the overfunding is within the control of the Board of Governors. Although it has the authority to terminate the plan, it also has the responsibility to purchase annuities for all those entitled to benefits under the plan in the event of plan termination. The Board of Governors would then determine the disposition of any funds remaining after satisfying this responsibility.

Remember, the obligation of the Red Cross to its retirees is twofold: a legal and contractual obligation and a moral obligation. The legal one is to meet the allowances called for in the defined benefit formula—it's strictly a mathematical process. The moral commitment is to try to provide retirees with an adequate standard of living. I'm sure the Board of Governors will strive to maintain that moral commitment.

"If by the term 'recapture' you mean terminating the plan . . . as far as I am concerned, there has not been any serious consideration of such an option."
—Richard F. Schubert

R. Has the Board of Governors or American Red Cross management seriously considered any proposals to recapture or reduce these assets?

S. No. If by the term "recapture" you mean terminating the plan so that all retirees are put on annuities . . . no. If we were a different kind of institution, there's no question that such an action would be very carefully considered. But as far as I am concerned, there has not been any serious consideration of such an option.

R. I fully agree with what you're saying about the excellent management and excellent investment results leading to the current overfunded condition of the Retirement System.

But I also think about where the money came from that is now escalating so rapidly: It came in part from staff members who made contributions for many years with a very low rate of return, and from the many people who left before being vested. The money that has built the fund also represents an investment by the Red Cross on behalf of staff members. And the returns to retirees for many years were very limited, which again had the effect of building the fund, so it could reach the levels we see today.

But what they have seen regarding their own retirement allowances is deferment of increases . . . appoint a committee . . . deferment . . . appoint a committee. So the **philosophy** of the Board of Governors and Red Cross management may be comforting to retirees, but the **behavior** has produced great anxiety. Can you see that the perception is not at all comforting?

S. Yes, and I hope that we can affect the perception by reminding retirees that the only thing that has happened in recent years that can in any way be considered adverse is not getting a 4-percent ad hoc increase last year.

* "Overfunding" in this context means that the assets are in excess of the obligations accrued to date.

Senator METZENBAUM. Our next panel is Mr. Bert Seidman, Director of the Department of Occupational Safety, Health and Social Security, AFL–CIO and Mr. Frank Higgins, American Association of Retired Persons of Washington, D.C.

Mr. Seidman, very happy to have you with us again, and as you know we have a five-minute limit and look forward to hearing from you.

STATEMENTS OF BERT SEIDMAN, DIRECTOR, DEPARTMENT OF OCCUPATIONAL SAFETY, HEALTH AND SOCIAL SECURITY, AFL–CIO, WASHINGTON, DC; AND FRANK HIGGINS, AMERICAN ASSOCIATION OF RETIRED PERSONS, WASHINGTON, DC

Mr. SEIDMAN. Thank you very much, Mr. Chairman. We in the AFL–CIO appreciate the opportunity to appear here today to share with you our views on pension plan terminations and reversions. We commend you, Mr. Chairman, for holding these hearings on this very very important issue. And even more for the long-standing commitment that you have demonstrated to seek a permanent and equitable solution to this problem. We are very, very grateful for the efforts that you have made.

Mr. Chairman, the AFL–CIO believes that when plans are terminated and excess assets, so-called excess assets, revert to employers, the promise of pension protection is broken and workers' hard earned pensions are threatened by the lack of basic benefit protection. Oftentimes workers are left with reduced pensions and replacement plans that lack benefit security. As our testimony will document, employers are terminating plans and recapturing assets, not to preserve workers jobs, but to finance corporate mergers and takeovers or in the worst instances, to get out of the pension business all together.

Unfortunately, legislative relief for this important problem has been largely subverted by conflicts over ownership of assets, over the question of who owns the assets, the employers or the employees and misperceptions about this problem. Before offering some guidelines for legislation that we would like to suggest, I want to debunk some common myths about terminations and reversions and I might add, Mr. Chairman, as you have well said, we have heard some of those myths this morning.

The first myth that engenders inaction on this very important issue is that the number of terminations of pension plans with reversions is no longer a problem because the trend has been down over the past few years. Now according to the PBGC, and we think that is the best source of information, the number of reversion cases has dropped, it is true, from 584 in 1985 to 264 in 1986, but held steady at 263 in 1987 and affected roughly the same number of participants.

We believe that if stock market conditions take an upturn or if there is additional legislation providing for excessive regulation of defined benefit plans which, by the way, particularly effects small employers, that terminations could resurge because according to the Department of Labor, 80 percent of defined benefits are "overfunded" and 50 percent are overfunded at levels exceeding 150 percent of termination liability.

The second myth is that most employers terminate plans and take reversions for business distress reasons which in some cases may preserve jobs for workers. Again, our source is the PBGC. And the PBGC data show just the opposite. Business necessity was cited in only 7.8 percent of reversions occurring since 1986 and the percentage has actually dropped from 9 percent in 1986 to 6.8 percent in 1987. What is important to note is that over this period, the majority of employers attributed terminations and reversions to corporate reorganization and their allegations of regulatory pressures imposed by ERISA.

Since 1980 employers have appropriated over $1.4 billion from pension plans that were terminated because of corporate mergers and buyouts. We question the prudence and ethics of using workers' pension funds for business deals that may cost them and have cost many workers their benefits, their jobs, and even their communities.

The third myth shrouding terminations and reversions is that most employers who terminate their plan and take a reversion provide their employees with a comparable replacement plan.

PBGC data confirms our worst fears about the decline of defined benefit plans resulting from terminations. As you are aware, compared with defined contribution plans, defined benefit plans provide superior benefits for workers with long service and a guaranteed level. I think we ought to be clear about what type of security is provided by various plans.

Senator METZENBAUM. Can you wind up in about a minute, Mr. Seidman?

Mr. SEIDMAN. I will do that. May I then turn to our specific recommendations. The AFL–CIO Executive Council recently established a special subcommittee on Pension Plan Terminations and Reversions. This subcommittee has approved a set of basic principles or guidelines that we think should be considered in any long-term legislation.

They are (1) if so-called excess assets exist after termination, workers and retirees should have the right to share in these assets with employers; (2) excess assets must first be allocated to satisfy the benefit security needs of workers and retirees before such assets are used for any other purpose. Benefit security should include assets necessary to fund benefits on an actuarially sound basis and assets necessary to shield plans for market down turns and inflation; (3) once benefits security is met, excess assets should be allocated among employers, employees, and retirees with financial incentives to encourage the continuation of defined benefit plans. When a pension plan is terminated, the percentage of excess assets made available to employers should bear a direct relationship to the type of replacement plan provided with the largest amount allocated to employers who establish defined benefit plans; (4) collectively bargained pension plans should be permitted to allocate excess assets for some other agreed upon purpose.

The AFL–CIO commends the subcommittee for focusing on this very important issue. We are eager to work with members of Congress to develop effective legislation and we thank you for holding this hearing and permitting us to share our views with you. I re-

spectfully request that my full statement which has been submitted to the committee be incorporated into the record.

Senator METZENBAUM. Without objection, it will be included in the record.

Mr. SEIDMAN. Thank you, Mr. Chair.

[The prepared statements of Mr. Seidman and the AFL–CIO Executive Council follow:]

TESTIMONY BY BERT SEIDMAN, DIRECTOR
DEPARTMENT OF OCCUPATIONAL SAFETY, HEALTH AND SOCIAL SECURITY
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS
BEFORE THE SENATE LABOR SUBCOMMITTEE
OF THE U.S. SENATE LABOR AND HUMAN RESOURCES COMMITTEE
ON PENSION TERMINATIONS AND REVERSIONS

FEBRUARY 9, 1989

The AFL-CIO appreciates the opportunity to present our views on pension plan terminations and reversions. We commend Chairman Metzenbaum for holding hearings on such an important issue and for his longstanding commitment to seek permanent legislation that protects the pension rights of workers and retirees covered by terminated plans.

The AFL-CIO believes that when plans are terminated and excess assets revert to employers, the promise of pension protection is broken and workers' hard earned pensions are threatened by the lack of basic benefit protections. As our testimony will document, employers are terminating plans and recapturing assets - not to preserve workers' jobs and strengthen the economic base of local communities - but to finance corporate mergers and takeovers or to get out of the pension business all together.

Whether explicit as in the case of collective bargaining or implicit in the case of non-union workplaces, workers forego wages and other benefits for pension benefits in the form of deferred wages. These deferred wages are trade-offs for a promise of a pension that is expected to continue and grow in

value and provide adequate retirement income for long-service employees. The $40 billion in annual tax breaks that employers receive for providing pensions is granted by Congress because of the legitimate expectation by workers and Congress that these pension plans are intended to be permanent.

Instead of assuring that their legitimate expectation will be met, current law protects employers by extending to them first and sole rights to so called "excess assets." Often times workers are left with reduced pension benefits in the form of annuities that provide no protection against inflation. Benefit security is jeopardized in replacement plans by depletion of assets necessary to meet funding commitments on an actuarially sound basis.

The $19.7 billion dollars taken by employers in reversions since 1980 and the 1.9 million plan participants affected by these reversions are a testament to the sheer magnitude of this problem. In fact, the $19.7 billion dollars in reversions represents an 11.6 % increase in total reversions over 1987. Unfortunately, legislative relief has been largely subverted by conflicts over ownership of assets and misperceptions of this problem. Before offering legislative guidelines, we want to try to debunk some common myths about terminations and reversions.

- The first myth that engenders inaction is that the number of terminations of pension plans with reversions is no longer a problem because the trend has

3

been down over the past few years. According to the Pension Benefit Guaranty Corporation (PBGC), the number of reversion cases has dropped from 584 in 1985 to 264 in 1986 but held steady at 263 in 1987. PBGC data for the first half of 1988 predicts a similar trend for this year. While total assets and reversion amounts did decrease from 1986 to 1987, the total number of participants affected by reversions also remained roughly the same for that two year period.

An upswing in reversions reminiscent of the 1985 peak period is not out of the question. Workers are still at risk of losing benefits because, according to Department of Labor data, 80% of defined benefit plans are 100% or more funded on a termination basis and 50% of plans are funded at levels exceeding 150%. An upturn in the stock market, or legislation providing for excessive regulation of defined benefit plans, could provide the necessary incentives for an upsurge in terminations.

Consideration should be given to whether the federal government's desire to raise revenues through OBRA '87's 150% full funding limit has in effect made a mockery of pre-funding pension plans and added more incentives for small, young plans to terminate.

o **The second myth is that most employers terminate plans and take reversions for business necessity reasons which in some cases may preserve jobs for workers.** The PBGC's quarterly survey of reversion cases that exceed $1 million or more defines business necessity to include: liquidation or dissolution of the employer; closing of a subsidiary, division, or plant; adverse business conditions; the plan being too costly to maintain; or bankruptcy.

Business necessity was cited in only 7.8% of reversions occurring since 1986. In fact, the percentage of business necessity reversions has declined from 9% in 1986 to 6.8% in 1987 with no reversions falling into this category thus far for 1988. What is important to note is that post-1986 reasons cited for employers recapturing assets are attributed to corporate mergers and to regulatory pressures imposed by ERISA.

The use of terminated pension fund assets to finance corporate takeovers is of particular concern to the AFL-CIO. Since 1980, employers have appropriated over $1.4 billion from pension plans that were terminated because of corporate mergers and buyouts. We question the prudence and ethics of using workers' pension funds for business deals that may cost them

their benefits, their jobs, and even their communities. The use of workers' pension fund assets to finance corporate raiding or to stave-off hostile takeovers is antithetical to the intent of the Employee Retirement Income Security Act of 1974 (ERISA), which was created to protect pension plan participants and beneficiaries from fiduciary actions that are contrary to their best interests.

o **The third myth shrouding terminations and reversions is that most employers who terminate a plan and take a reversion provide their employees with a comparable replacement plan.** PBGC data confirms that terminations may be contributing to the rapid decline in the number of defined benefit pension plans, a trend the AFL-CIO strongly believes is detrimental to workers. The labor movement has long preferred defined benefit plans because, compared to defined contribution plans, these plans place workers at the least risk for investment performance and provide superior benefits for workers with long service.

PBGC data confirms our worst fears about the decline of defined benefit plans resulting from terminations. Successor defined benefit plans decreased from 52% in 1985 to 38% in 1987 while during this same period successor defined contribution plans increased from 29.5% to 36.5%.

Even more distressing is recent PBGC data that shows a rapid increase in the worst case scenario for workers in terminations -- the case of no replacement plan. PBGC data shows an increase in the number of plans that filed termination notices without replacements from 18.5% in 1985 to 25.6% in 1987. The Employee Benefit Research Institute estimates that in 1988, 50% to 75% of all terminated plans may result in no replacement plan.

Study after study has shown that workers, not employers or the government, bear the brunt of plan reversions. Put simply, the Department of Labor estimates that participants lose an average of 45 cents for every pension dollar they would have received if the plan had not been terminated.

Our members are keenly aware of the adverse impact of takeovers on the pension benefits. For example, the Texaco buyout of Getty Oil Company in 1984 involved serious pension abuses for members of Local 898 of the Oil, Chemical, and Atomic Workers Union. Texaco terminated the Getty plan and raided $250 million from the 18,700 former Getty employees. Because Texaco's pension plan generates a lesser pension than the Getty Oil plan did for similar service and pay class, employees who retired after the buyout found that their pension benefits had not increased in value in the four years following the takeover prior to their retirement. To add insult to injury, the $250 million that Texaco took from the terminated plan was used to fight off

several subsequent takeover attempts and not to improve workers' wages or working conditions.

Congress must stem the tide of these reversions by acting expeditiously to pass legislation for a permanent and equitable solution to employer raiding of pension plans. Although Congress recently increased the excise tax on reversions from 10 to 15% and Treasury has temporarily halted the processing of termination requests, we still need to develop comprehensive legislation that will end the termination of pension plans that lack worker participation and protection.

The AFL-CIO recently adopted a number of principles which should be reflected in long-range legislation. In February 1988, the AFL-CIO Executive Council issued a statement on Terminations and Reversions calling for ending any unilateral right of employers to excess assets and urging Congress to take corrective and speedy action. I have attached this statement to my remarks. Upon issuing this statement, the AFL-CIO established a special Subcommittee on Pension Plan Terminations and Reversions, chaired by President Morton Bahr of the Communication Workers. This subcommittee has approved a set of basic principles or guidelines that should be incorporated in any long-term legislative remedy which can be summarized as follows:

1. If so-called "excess assets" exist after a termination, workers and retirees should have the right to share in these assets with

employers.

2. Excess assets must first be allocated to satisfy the benefit security needs of workers and retirees before such assets are used for any other purpose. Benefit security should include assets necessary to fund benefits on an actuarially sound basis and assets necessary to shield plans from market downturns and inflation.

3. Once benefit security is met, excess assets should be allocated among employers, employees and retirees with financial incentives to encourage the continuation of defined benefit plans. When a pension plan is terminated the percentage of excess assets made available to employers should bear a direct relationship to the type of replacement plan provided, with the largest amount allocated to employers who establish defined benefit plans.

4. Collectively bargained pension plans should be permitted to allocate excess assets for some other agreed upon purpose.

We believe these principles lay the groundwork for worker pension protections that are sorely lacking in current law.

The AFL-CIO commends the Committee for focusing on the serious abuses of our pension system and the lack of basic benefit protections for workers. We urge Congress not to allow pension law to be driven by budgetary concerns. This issue must be treated as one of rights and equity -- the urgency of which has not been recognized in aborted past attempts to reach a permanent legislative solution. We are eager to work with Members of Congress to develop effective legislation which will assure the retirement protection workers have a right to expect from their plans.

Thank you.

Statement by the AFL-CIO Executive Council

on

Pension Plan Terminations and Reversions

February 16, 1988
Bal Harbour, FL

The long-term economic security of nearly two million workers has been jeopardized by management appropriation of more than $17 billion of terminated single-employer pension fund assets since 1980.

This wholesale looting is carried on by Wall Street raiders who cash out pension plans to finance corporate takeovers and by corporate managers who skim so-called "excess" assets when market values are high, leaving too thin a margin to meet pension obligations when values decline.

Since pension contributions represent the deferred wages of the workers who earned them, justice requires that workers share in any distribution of assets that exceed liabilities. Indeed, the Department of Labor's own Task Force on Asset Reversions and its Advisory Council on Health, Welfare and Benefit Plans recommend that workers and retirees share in recovered assets when plans are terminated.

Currently, employers who terminate existing single-employer pension plans may retain all remaining assets once annuities have been purchased to cover accrued pension obligations at the time of termination. This practice places retirees in serious jeopardy. Even if employers establish a replacement plan, they frequently reduce past service credits and almost always rob retirees of future cost-of-living adjustments. Even worse, the so-called "exess assets" may be used to finance anti-union corporate takeovers or mergers and rarely, if ever, are these monies used to help employees.

The AFL-CIO calls on the Congress to protect workers' retirement security by restricting corporate raids on pension funds and by assuring that workers share fairly in

so-called excess assets of terminated pension plans. We also urge the adoption of strong economic incentives to encourage the replacement of terminated plans by new plans that fully meet the needs of their participants and beneficiaries. At the very least, a temporary moratorium should be enacted to prevent recovery by employers of so-called excess assets from terminated single-employer plans.

We call on the Ad Hoc Committee on Investment of Union Pension Funds to coordinate labor's legislative efforts in this area.

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Fact Sheet on Pension Plan Terminations and Reversions

Fact Sheet

on

Pension Plan Terminations and Reversions

In recent years, employers have been terminating single-employer defined benefit pension plans for the sole purpose of recapturing assets in excess of termination liabilities.

In these situations, there is no requirement that employers replace terminated plans with new plans which fully protect their participants and beneficiaries. Thus, workers who participate in terminated plans have found their retirement security placed in serious jeopardy. Since 1980, according to data collected by the Pension Benefit Guaranty Corporation, 1,556 private pension plans have been terminated and $17.5 billion in so-called "excess" assets have been recaptured by employers.

As a result of these terminations and reversions, workers lose benefits that would otherwise have been earned through future service with their employers. In addition, even if employers establish replacement plans, it is unlikely that workers will receive benefits that are equivalent to those provided under their original plans.

Single-employer pension-plan terminations falls into four basic categories:

* Spin-offs where a single plan is split into two plans, one covering active participants and the other covering retirees and inactive participants. The excess assets are allocated to the plan covering retirees and inactive participants, and that plan is then terminated, enabling employers to recover the excess assets.

* Situations where a new plan is established for active participants. Many of these replacement plans do not give participants credit for past service.

* Situations where a defined contribution plan (including profit-sharing, stock ownership and 401(k) plans) is established in lieu of the prior defined benefit plan.

* Situations where no replacement plan is established.

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Senator METZENBAUM. Mr. Higgins, we are very happy to hear from you, sir.

Mr. HIGGINS. My name is Frank Higgins and I am pleased to testify today on behalf of AARP on the important issue of pension termination for reversions. With me is David Certner of the AARP legislative staff. Let me first commend the chairman for his leadership on this issue and thank him for his efforts on behalf of pension plan participants.

AARP believes that terminations for reversions are harmful to the long-term benefit security of plan participants and contrary to the basic thrust of our pension and tax laws. In general, defined benefit plans promise a specific benefit at retirement. This benefit usually based on salary and use of service increases more rapidly in later years. In order to meet this benefit obligation, the employer prefunds his pension plan. This prefunding coupled with higher than expected market returns has led to a larger buildup in pension assets.

These assets generally needed to meet the long-term retirement security of workers and retirees are now viewed as a piggy bank by the employer. Since 1980, about 2,000 companies have raided their pension plans recapturing nearly $20 billion of plan assets. About two million plan participants have been affected. In a termination, active employees lose out on the best years of their pension promise, often leading to substantial pension losses. In particular all the workers who have already invested much time in the plan may be harmed. For retirees, the removal of plan assets means the opportunity of any adjustment to their frozen pension amounts effectively disappears.

Also all participants and the Federal Government take the risk of stripping pension funds of their needed cushion of funds. The importance of such a cushion was dramatized by the recent stock market crash in which pension funds lost about 20 percent of their value over night. In addition, recaptured pension money has fueled the takeover activity on Wall Street. The need for short-term cash flow, both to fight off and engage in takeovers, has led directly to the pension piggy bank.

Congress and the Administration have in the past proposed solutions to this problem. The House and Senate have both passed legislation that would restrict reversions yet no comprehensive legislation has been enacted and the pension raid continues. AARP believes action is long overdue. Enacting legislation restricting access to plan funds should be a top priority.

The association has supported reforms in the past and will continue to do so. Such reforms include a redefining of pension excess to more accurately reflect funding obligations; a sharing of reversion assets with employees and retirees; a cushion of assets in any newly formed plan; a higher excise tax on employers; and a prohibition on asset reversions related to takeover activity.

Those who defend the status quo that allows the return of tax preferred assets to the employer undermine the basic thrust of our pension laws. The large tax subsidy for pension plans should lead to long-term retirement security, not back to the employers' pocket. The current shortsighted view of pension assets threatens

future benefits security and undermines faith in the pension system.

AARP believes restrictions on termination for reversions are thus essential and stands ready to help this Committee and this Congress to enact much needed legislation. Thank you very much.

[The prepared statement of the AARP as presented by Mr. Higgins follows:]

AARP

STATEMENT

OF THE

AMERICAN ASSOCIATION OF RETIRED PERSONS

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

ON

PENSION TERMINATIONS FOR REVERSIONS

FEBRUARY 9, 1989

American Association of Retired Persons 1909 K Street, N.W., Washington, D.C. 20049 (202) 872-4700

Louise D. Crooks *President* Horace B. Deets *Executive Director*

The American Association of Retired Persons (AARP) appreciates the opportunity to express its views on the termination of pension plans for reversions. The Association believes that the termination of pension plans in order to gain access to pension funds has adverse consequences for pension plan participants and must be restricted. AARP would also like to commend the chairman for his leadership on this issue, and for his continued efforts to reform this pension inequity.

Background

The ultimate goal of changes in the income support structure serving retired Americans must be the establishment of a minimum standard of living for all older Americans. This should include a reasonable guarantee of adequacy, stability, and security of retirement income so that individuals can plan for their later years. Social Security is the basic foundation for retirement income planning. To achieve adequacy -- a level that is sufficient to prevent a significant decline in the standard of living -- Social Security must be supplemented by income from other sources, particularly the private pension system.

The Employee Retirement Income Security Act (ERISA) was intended to protect the rights of participants and their beneficiaries under private pension, health and welfare plans. ERISA sets certain minimum standards for the protection of plan

participants, particularly in the areas of vesting, participation, and funding. In addition, ERISA establishes a strict standard of conduct for plan fiduciaries -- those who have been empowered to administer and manage the assets in a plan. ERISA requires that a plan fiduciary act "prudently" and "solely in the interest of plan participants and their beneficiaries."

According to recent Department of Labor estimates, private pension funds contain approximately $1.7 trillion in plan assets. Approximately $50 billion in foregone tax revenue per year, the largest single tax expenditure, is allocated to pension funds in order to help foster their growth and security.

Termination of Pension Plans to Gain Access to Plan Funds

The money building-up in pension funds for future retirement security -- in defined-benefit plans in particular -- has been exploited in recent years as a ready source of cash for non-retirement purposes. Under current law, a company cannot pension plan, pay benefits that were earned up to the date of plan termination, and recapture any assets that remain in the pension trust. There are no restrictions on the employer's use of these assets (although a 15 percent excise tax applies).

In general, defined-benefit plans are plans that promise a specific pension benefit upon retirement. The benefit amount is usually based on a formula involving number of years of service and salary. Because of this formulation, these plans tend to accrue benefits more rapidly in the later years of an individual's work life, when both salary and number of years on the job is highest. In order to account properly for the build-up in pension benefits in the later years, companies generally are required to prefund their pension benefits in the early years.

This prefunding, coupled with better than expected returns on investment of plan funds, has led to a large build-up in pension funds beyond what is currently needed to satisfy the accrued benefits of plan participants. A recent study of Fortune 500 companies (using 1987 financial statements) indicated that 86 percent of companies had assets in excess of their accrued pension benefit obligations. While these funds will for the most part be needed in on-going plans to meet future benefit obligations, they are considered "excess" on a current plan termination basis (i.e., benefits currently owed if a plan is terminated today). In total, it has been estimated that the current amount of pension fund "excess" on a plan termination basis is about $200 billion.

While originally intended for long-term retirement security, the build-up of assets in defined benefit plans has become an attractive short-term pot of gold. Employers have sought access to pension assets for any number of reasons, such as improving the outlook on the balance sheet or financing corporate takeovers. This diversion of retirement funds from their intended purpose frustrates the goals of the private pension system and threatens the retirement security of thousands of individuals.

Scope of Problem of Terminations for Reversions

The scope of pension terminations for reversions in this decade is alarming. Terminations for reversions were essentially unknown before 1980. Since that time, and as of September 30, 1988, (according to the most recent Pension Benefit Guarantee Corporation (PBGC) information), nearly two thousand plan terminations with reversions of over $1 million have been completed. The total amount of recaptured pension assets has now reached nearly $20 billion, and the number of plan participants affected by these terminations has reached nearly 2 million.

Attempts to discourage and restrict these terminations for reversions have been on the legislative agenda for the past several years. While most agree that terminations are a problem that must be resolved legislatively, an acceptable solution has yet to be enacted.

A number of Congressional hearings have been held on this issue over the past seven years. Administrative task forces have looked into the problem. Bills have been introduced in Congress to reform the pension laws to restrict terminations for reversions. Legislative solutions have been passed by both the House and the Senate. The Administration has offered its own solution of how to discourage terminations and better protect the benefit security of pension plan participants. The General Accounting Office (GAO) in a 1986 report noted that Congressional oversight was warranted because "many employers were terminating plans with excess assets because of a desire to use the excess assets for non-pension related purposes, such as alleviating adverse business conditions or retiring long-term debt."

Despite past efforts, the raiding of pension plans continues. AARP believes that action is long overdue. Legislation restricting the current practice which allows a company to terminate a plan and strip it of funds intended for future retirement security must be enacted. Prior legislative efforts to curb this abuse have made only modest progress in the past few years, and the threat to employee and retiree benefit security remains high.

Harm to Plan Participants

Generally, whether an employer establishes a new pension plan (and what type of plan) determines the extent employees are made worse off. Again, PBGC data on pending pension terminations as of September 30, 1988, is instructive. According to the PBGC, one-quarter of plan participants are in plans that have not established a new plan. In addition, one-half of plan participants are in plans which have created new defined contribution plans, plans in which investment risk falls on the employee. Only one quarter of participants are in plans in which the employee is generally best protected -- a reestablished defined benefit plan. Even in these instances, the plan is bound to be far less well funded, since the "cushion" of assets that had been built up has now been stripped by the termination.

To demonstrate the effect a plan termination may have on an employee, it is instructive to look at an example of an older worker in a typical defined benefit plan that is terminated. If no replacement plan is established for a hypothetical 55 year old worker (with 30 years of service) who intends to work to age 65, the reduction in benefits can be over 50%. Even if a defined contribution-type plan is established, it is practically impossible to make up for these losses.

Company retirees may also be hurt in a plan termination. In a termination, annuities are generally brought to cover retirees' benefits. The practical result is that retirees are unlikely to receive any future pension adjustment. This contrasts with the latest Department of Labor information that suggests that nearly 40 percent of retirees in continuing pension plans have received some type of ad hoc pension adjustment to compensate for the loss of value in pension amounts over time.

While the incidence of reversions has declined from its peak in 1985 (many of which were rushed through to avoid the reversion penalty tax enacted in the Tax Reform Act), AARP believes the threat of terminations for reversions remains a serious problem. First, a number of companies have already taken reversions, suggesting that the decline is only temporary because they have recently taken their "first bite" of the pension apple. Second, interest rates are high, which makes annuities cheaper to purchase, leaving more assets for the employer to recapture in a plan termination. Third, Congressional action in the past few years has likely inhibited some reversion activity. This includes various proposed restrictions which have not been enacted, but have likely caused uncertainty. (Currently, a Treasury Department letter from October 22 of last year, set to expire on May 1 of this year, has put a temporary halt on granting termination letters for reversions.)

In addition, the Association believes that pension plan assets will continue to play a significant role in mergers and acquisitions. To the extent that the markets and corporate managers are preoccupied with cash flow, pension assets will remain a target.

Role of Reversions in Mergers and Acquisitions

The recent wave of corporate takeovers has recently received much Congressional and public attention. Recaptured pension funds have helped fuel these mergers and takeovers, as illustrated in the following ways: Company A may take over Company B, then terminate Company B's pension plan, removing any pension funds not needed to pay plan benefits earned up to that date. These recaptured funds may then be used to help pay off corporate debt originating from the original takeover. On the other hand, Company B, realizing it is the target of a takeover, may prematurely terminate its own plan in order to gain access to cash to help it fend off a takeover bid. Company B's termination of its own plan may also make it a less attractive takeover target.

To underscore the role that pension assets have played in mergers and acquisitions, it is instructive to review PBGC lists of companies that have completed terminations for reversions, and compare them with companies that have been involved in merger and

acquisition activity. While it is difficult to trace the exact use of money recaptured from pension funds, the cross-match of companies highlights the current threat to participant's pension security.

Preliminary figures indicate a strong correlation between companies with terminations for reversions and those involved in mergers and acquisitions, particularly where large pension reversions are involved. For the companies with the largest pension reversions (over $50 million recaptured by the employer) between January 1, 1986 and September 30, 1988, about 65 percent (11 of 17) had also been involved in merger and acquisition activity. The total amount of pension reversions in this time period for these companies equals about $3 billion. No doubt a portion of these recaptured pension funds played a significant role in non-pension related actions.

Recommendations:

AARP continues to believe that terminations for reversions are harmful to the economic security of current and future retirees. The Association has long urged restrictions on terminations for reversions, and has pointed to their use in takeovers and acquisitions as particularly undesirable diversions of retirement funds for non-retirement purposes, and often for activities of questionable economic value.

The Association has supported policies to discourage terminations for reversions and to provide protections for employees and retirees. Reforms include:

* a redefining of "excess" to more accurately reflect funding obligations,
* a "sharing" of reversion assets with employees and retirees,
* a "cushion" of assets in any newly formed plan,
* a higher excise tax on reversions to employers, and
* a prohibition on asset reversions in takeover activity.

Proponents of the Status Quo

There are many who believe that the interpretation of current law which allows a company to gain access to plan funds in a plan termination should not be changed. AARP believes this view is inconsistent with the basic intent of our pension and tax laws.

Opponents of restrictions on plan reversions contend that the inability to recapture plan funds will cause employers to underfund their pension plans. AARP believes such a view was not held by employers in the pre-1980 period, when access to plan funds was essentially unknown. Employers at that time (as should be the case now) funded their plans consistent with actuarial determinations of funding needs in an on-going pension plan.

Funding reforms enacted in 1987, which generally increased the levels of funding necessary in defined-benefit plans, should further prevent employers from intentionally underfunding their plans. In addition, plans should not be encouraged to build-up plan assets on a tax-preferred basis merely to have them revert to the employer later.

Employers also argue that in a defined-benefit type plan, which guarantees a specific benefit upon retirement, the employer takes all the risk, and therefore should be able to reap all the gain. AARP believes this argument is misplaced in several basic respects. First, employers do not take all the risk. The tax code provides significant tax benefits for pension plans, allowing both deductions for contributions to plans and tax-free build-up of pension fund assets. The reason for this tax advantage is to better provide for retirement security. Therefore the federal government, and all taxpayers, have a substantial stake in the growth in pension funds. Second, in the event of an economic downturn, the PBGC will step in to insure that pension participants receive at least some of their guaranteed pension benefits. Thus, the pension "risk" is spread beyond each individual employer.

Even more basic is the concept that there is any "gain" at all. Using "current plan termination basis" for calculating pension "surplus" is, in our view, misleading. In an on-going pension plan, there generally are few, if any, "surplus" pension assets. Assets accumulating in the plan are intended -- and actuarily determined -- for future retirement benefits. Large "surplus" assets are created by the act of plan termination itself. This short-sighted characterization of pension assets in a plan termination is at odds with the basic intent of ERISA and the tax laws to provide for long-term retirement security. For example, the recent stock market crash demonstrated what could happen to so-called pension plan surpluses, causing an estimated 20% overnight reduction in the value of pension assets. Long-term benefit security is ill-served by a short-term snapshot view -- such as in a plan termination -- of assets accumulating in pension plans.

In fact, the law already provides the employer with a "gain" from better than anticipated returns on investment -- the ability to reduce contributions in later years. This gain, determined actuarily year-by-year in an on-going pension plan, is one that provides for long-term stability. Long-term accountability such as this is more consistent with the basic thrust of ERISA and the tax laws.

Conclusion

In conclusion, the Association believes the recent wave of terminations for reversions has had a detrimental impact on benefit security. This activity has been exacerbated in the context of corporate takeovers. Already, over $20 billion has been removed from pension plans and diverted for non-retirement purposes, frustrating the basic intent of ERISA and the Congress to foster retirement security.

Congress has examined this issue for years, and it is now time to act. AARP hopes to continue working with this committee to quickly enact legislation to restrict terminations for reversions and to better insure retirement income security.

Senator METZENBAUM. Thank you very much, Mr. Higgins and Mr. Seidman. I had a couple of questions, but I think you pretty much covered them in your statements. I want to be certain that I give the employer representatives adequate time and the chair has another commitment at 12 o'clock. I am not going to ask you any questions. Your entire statements will be included in the record. And I want to say on behalf of the Committee how much we appreciate your support, as well as your concern about problems of this nature in the Congress over a long period of time.

Mr. HIGGINS. Thank you very much, Mr. Chairman.

Senator METZENBAUM. Our next and last panel is Peter M. Kelly, partner, Bell, Boyd and Lloyd, on behalf of the U.S. Chamber of Commerce of Chicago, and Mr. Vance Anderson, Employee Relations Counsel of Mobil Oil Corporation, on behalf of the Association of Private Pension and Welfare Plans in New York City.

I think you both know of our five-minute rule and we are very happy to hear from you, Mr. Kelly.

STATEMENTS OF PETER M. KELLY, PARTNER, BELL, BOYD & LLOYD, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE, CHICAGO, IL; AND VANCE ANDERSON, EMPLOYEE RELATIONS COUNSEL, MOBIL OIL CORP., ON BEHALF OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, NEW YORK, NY

Mr. KELLY. Yes, good morning, Mr. Chairman. It is particularly gratifying to be appearing before the Senate of the United States, a charitable organization that is prepared to pass up pay increases and do other things to benefit the Federal budget. It is quite inspiring.

Senator METZENBAUM. We have a new tax, we are going to levy on lawyers, so do not be so happy about that, in order to balance the budget.

Mr. KELLY. I am sure we will leave here so inspired by your example that we will gladly pay that tax. In any event, I have prepared written remarks. I would like them to appear in the record.

Senator METZENBAUM. No objection. The entire remarks will be included in the record by both witnesses.

Mr. KELLY. I am accompanied by Lisa Sprague of the Chamber. I will not read this statement. I will not even hit the main highlights. I would like to focus on just a few items. It is important that the reasonable expectations of parties to agreements be upheld. We heard some examples earlier that I will not call typical examples. They are also examples that we have only heard from one point of view.

In any event, I think that the heart of it, we are talking about proposals that have been made over recent years to change the fundamental nature of the retirement commitment. The fundamental rules that have been in effect for 50 years. And in doing so, there has been an erosion of employers' expectations. I would like to focus on what the impact of this has been, and I do have a visual. I hope you will bear with me while I talk about it.

If we look during the period of time up until ERISA, there was a fairly stable practice in employment of about 50 percent, a little more than 50 percent of all new plans, it is based on IRS termina-

tion letter statistics, net of plan terminations which during this period averaged about 500 plan terminations a year. There is a very stable degree of incoming, new defined benefit plans, rate of formation of new defined benefit plans. What this chart illustrates more than anything else is that one of the most important determinants of what plans are maintained is the rules that apply to those plans. Now immediately after ERISA, there was an enormous dip in net plan formation. There were vastly more plans terminated in the first year—as you will see from the chart accompanied and that this graph is based upon—in the first year that ERISA became effective, 1976. It was primarily a group of employers leaving the pension system. They were not prepared to live with the funding standards, they were not prepared to live with some of the strict defined benefit rules.

Since then there was a growth back to maybe a stable post-ERISA rate of some where in the range of 35 to 40 percent of new plan formations and then of terminations were defined benefit plans. But two very important things happened during the periods between 1984-85 and basically what you are looking at—and 1983 and 1984. Late in 1983, issues arose about the ability to set up a substitute plan, that it would be considered a successor plan, and therefore that PBGC approval would not be granted.

In addition, that was the beginning of the serious proposals for moratoriums on terminations and employers began, as you can see particularly in 1984, simply refrained from forming plans on a net basis in 1984.

Senator METZENBAUM. Are you saying that the ERISA should not have been enacted?

Mr. KELLY. No, I am not saying that, Senator. I think it has been a tremendous boom. There may be employers who simply on an ongoing basis were not willing to live with the ERISA rules and maybe the new, more stable post-ERISA rate of participation is not the 50 percent rate, but maybe the appropriate rate for now is 35, 40, 45 percent of new plans. Maybe that is where it ought to be and time will tell where that is and where it will eventually be.

Meanwhile after the implementation guidelines and some stability was returned to employer expectations, the unwillingness to form new defined benefit plans seemed to range somewhat until two events occurred just prior to the last two years, 1987-88. During those periods we had the enormous increase in the premium taxes for the PBGC and we also had the excise, serious attack on the right of employers to recover excess assets. And that effect has been down in 1988 something slightly in excess of 13 percent, net of terminations of new qualified plans or of the defined benefit variety.

Now I would like to make a few predictions, talk about where we ought to be going with this. Because I think what we are talking about when we are talking about whose assets they are and how to split those assets is we are talking about a fairly fragile defined benefit mechanism that is threatened. And I do not think that at a 13 percent rate of new plan formation that defined benefit plans are going to perform anywhere near to the capacity they have in our system or anywhere near at the levels that employers histori-

cally proved they were willing to maintain and establish defined benefit plans.

I think what we are faced with, I will draw the analogy to battleships after World War II. After World War II, we did not need battleships or not as many, and we carefully put them in mothballs. We made sure the mechanism was working. We took care of the mechanism. We needed battleships again on at least three occasions where they were taken out of mothballs. That is in effect what is happening to the defined benefit system. The fastest growing group of workers are service workers, nonunion workers. The baby boom is a younger work force. A defined contribution plan is a young person's plan.

In about 10 to 15 years, I would expect that due to normal economic factors and demographic factors, there will be again a need for a dramatic role to be played by defined benefit plans. If the mechanism is so flawed because rather than mothballing this system, we fought over the scavenging of the assets and we scuttled the system, then employees will not turn to defined benefit plans when we need them to in about 10 or 15 years.

Mr. KELLY. So my bottom line suggestion to you, Mr. Chairman, is please take a look at these figures, have your staff analyze them closely, look for other factors. These are only a modest suggestion of a trend. There is still much to be looked at to determine what the trend will actually be, and let us not scuttle the system. Thank you.

[The prepared statement of Mr. Kelly follows:]

TESTIMONY
ON
PENSION REVERSIONS
BEFORE THE
LABOR SUBCOMMITTEE
OF THE
LABOR AND HUMAN RESOURCES COMMITTEE
OF THE
UNITED STATES SENATE
ON BEHALF OF THE
U. S. CHAMBER OF COMMERCE
BY
PETER M. KELLY
FEBRUARY 9, 1989

My name is Peter M. Kelly. I am a partner in the law firm of Bell, Boyd & Lloyd. I am based in that firm's main office in Chicago, Illinois, and head the firm's employee benefits group. I am a member of the Health and Employee Benefits Committee of the United States Chamber of Commerce (the "Chamber"). I appear before you on behalf of the Chamber to express the Chamber's views on the subject of the reversion of assets remaining in terminated defined benefit pension plans to the employers sponsoring such plans following full satisfaction of promised benefits. I am accompanied by Lisa Sprague, the Chamber's Manager, Pension and Employee Benefits.

Our primary concern in presenting comments to this Subcommittee is to insure that the views of the Chamber are heard in opposition to the confiscatory excise tax on excess asset reversions and in opposition to any efforts to overturn the time-tested principle of law that employers whose plans have reached the end of their life cycle should be entitled to recover any excess assets remaining in those defined benefit pension plans.

The excise tax on excess asset reversions was adopted in late 1986 and was increased by 50 percent effective in mid 1988. This excise tax has resulted in dramatic acceleration of the trend away from defined benefit plans. Such excise taxes unjustly defeated the reasonable expectations of employers who established such plans and fully funded them before this tax went into effect. Such full funding was the result of justifiable employer reliance on the laws previously applicable to such plans. This excise tax falls most heavily on the most prudent of employers, employers who fully fund plan benefits and

who manage plan assets successfully. The adoption of ever more restrictive laws governing defined benefit plans must stop if such plans are to remain a viable plan design option.

It is important to keep in mind that employers who recover excess assets are, by definition, employers who have kept their pension promises. Prior to termination of their defined benefit pension plans these employers bore the risk of underfunding. It is appropriate that excess assets which remain should be returned to these employers. This principle has been repeatedly upheld by the courts. As we describe in detail below, this principle has been a key element in the nation's retirement policy and an element on which employers have relied in establishing defined benefit pension plans over the past 50 years.

I. Preserving Defined Benefit Plans as a Viable Plan Design Option

The trend away from defined benefit plans dates back to enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"). Although the reforms in the structure of the termination insurance systems temporarily slowed or reversed this trend, the combined effect of higher termination insurance premium taxes enacted in 1986 and 1987 and the excise taxes enacted in 1986 and 1988 has drastically accelerated the decline in the net rate of formation of new defined benefit plans. An exhibit is attached which illustrates the declining role of defined benefit plans as a new plan option. This exhibit illustrates the number and percentage of new plans which are defined benefit plans. The exhibit reflects both the gross figures and the figures net of plan terminations. This exhibit is based on Internal Revenue Service determination letter records.

During the 15 years prior to enactment of ERISA the percentage of new plans established (net of terminating plans) which were defined benefit plans ranged from a high of 57.88 percent in 1972 to a low of 50.12 percent in 1960. This relatively stable rate of defined benefit plan formation was even more dramatic since defined benefit plans tend to be established by larger companies and cover a larger number of participants than do defined contribution plans.

In the early years after ERISA, the rate of formation of defined benefit plans dropped precipitously as many employers permanently left the defined benefit system. During the first three years ERISA was in effect, the net number of new defined benefit plans was at or below ten percent of the total number of new plans (net of terminations). The low point was in 1976 in which 4,180 more defined benefit plans were terminated than were established.

By 1982 and 1983 the rate of formation of new defined benefit plans had grown steadily to the point that 32.97 percent and 32.7 percent, respectively, of new plans (net of terminations) were of the defined benefit variety. This was to be the post-ERISA high water mark for the rate of formation of new defined benefit plans. The concerns over the availability of excess assets caused a rash of terminations in 1984 which abated somewhat by 1985 and 1986. But the one-two punch of higher termination insurance premiums and new excess asset excise taxes produced a precipitous drop in net defined benefit plan formations in 1987 and 1988. In the 12 month period ended September 30, 1988 only 13.52 percent of net new plans (net of terminations) were defined benefit plans.

It is no accident that there has been an increased incidence of reversion activity over the past four to five years. This increased termination activity corresponds with the time period during which serious efforts have been made to undermine the ability of employers to recover reversions in the event of plan terminations.

As the statistics described above prove, our prediction in January 13, 1986 testimony before a task force of the Department of Labor Advisory Council on Employee Welfare and Pension Benefits Plans has been proven accurate:

> Any unjustifiable restriction on reversions will, without any doubt, result in fewer defined benefit plans. Employers will simply not commit themselves to a one-sided deal in which the rules are "heads we win and tails you lose."

Other factors have also contributed to the trend in slower formation of new defined benefit plans. The fastest growing jobs in recent years have been nonunion service jobs not traditionally involving defined benefit plans. In addition, the baby boom generation has not yet reached the age when the advantages of defined benefit plans surpass the perceived value of the flexibility and the growth potential of defined contribution plans such as 401(k) plans.

These demographic and business trends which have contributed to the decline in defined benefit plans will eventually be reversed. As service workers and their employers become more institutionalized and as the baby boom workers age without adequate savings, pressure will increase for defined benefit plans. However, we are concerned that the restrictive rules have imposed burdens on such plans which have become so great as to prevent such plans from ever again performing a predominant role in building

new retirement savings. Defined benefit plans will only be utilized if the rules applicable to such plans are made more rational.

There is a difference between new stricter funding and tax rules which carefully mothball the defined benefit plan mechanism for future use and rules which are so onerous as to scuttle such plans as a reasonable business alternative. The capacity of such plans to efficiently accumulate retirement benefits is no less a national resource than the battleships so carefully mothballed after World War II. The national interest requires that you not squeeze the last ounce of usefulness out of such plans for the current generation of retirees at the expense of the next generation.

We urge you to approach your deliberations regarding the expiration of the current reversion moratorium from this perspective. If you do, we are confident defined benefit plans will resume their preeminent role as a retirement mechanism in about ten or 15 years when the employees on the leading edge of the baby boom generation attain their early to mid 50's.

II. Preservation of Employer's Reserved Rights To Recover Excess Assets

In your deliberations, we encourage you to keep in mind that there is a difference between a plan which has reached the end of its life cycle and an ongoing plan. Assets held in an ongoing plan must continue to be subject to appropriate limitations to protect plan participants. However, once a plan has terminated with payment in full of all promised benefits it is no longer appropriate to impose limitations or restrictions on the business decisions of the plan sponsor regarding the use of excess assets. In this regard it is important to subject the arguments of participants and their representatives to careful scrutiny. Many such claims are not founded upon reasonable expectations but are merely an asset grab. The bargained wage theory sounds good but does not stand up to rigorous analysis. There were two parties to any such bargain and both are entitled to the benefit of their bargain. Once all benefits have been paid, the excess assets which remain should be returned to the enterprise for the benefit of employees and shareholders alike if the plan documents clearly provide for such disposition. It is too easy to forget about the rights of shareholders to share in the value of such excess assets and the positive effects on employees and others of returning excess assets to the business for reinvestment. As often as not the shareholders of public companies are pension plans and other institutions with a superior claim to such assets than the participants who have received the full benefit they were promised.

The Chamber is concerned about repeated efforts to overturn the time-tested principle that employers who prudently fund their defined benefit pension plans and keep their pension promises should be allowed to recover any assets remaining after a plan termination. This principle has been a key element of our national pension policy for at least 50 years and has provided an environment which is conducive to employer voluntary creation of pension entitlements.

By prudently funding its plan, an employer entitled to a reversion has successfully avoided the dangers to itself, its shareholders,its employees and to the termination insurance system which are implicit in the maintenance of an underfunded plan. In addition, by complete funding of benefit entitlements, such an employer has fulfilled its pension promises. As such plans reach the end of their life cycles, the employers maintaining those plans only seek what is their due when they recover excess asset reversions. The reversions which they receive and include in taxable income represent the flip side of the risk they previously took. They were obligated to make up any short-falls during the life of the plan. Now they only seek a return of what is theirs.

Current Rules

We suggest that your study should begin with a restatement of the existing rules and the national policy implicit in the rules applicable prior to enactment of the reversion excise tax.

1. Defined Benefit/Defined Contribution Distinction . In the debate over pension plan terminations a fundamental point is sometimes obscured. There is a significant difference between pension plans of the defined benefit variety and other forms of employee retirement plans (defined contribution plans). Under each type of plan the rewards of better than expected investment performance goes to the party that bears the risk of investment losses.

Employer contributions to a defined benefit plan are in effect a down payment on each participant's fixed or determinable retirement benefit. In an ongoing plan, participants are entitled to receive the benefit provided in the plan even if due to investment losses or other adverse actuarial experience the cost of that benefit is greater than the participant's proportionate share of plan assets. Any such shortfall, if not offset by subsequent favorable experience, must be made up through future increases in the employer's contributions. Thus, employees know they will receive no more nor less than the plan formula benefit and are relieved of the risks of investment or other plan losses. These risks

fall upon the employer who is obligated to make the required pension contributions which together with investment earnings will be sufficient to meet the pension promises contained in the plan. If plan assets are insufficient such employers must contribute additional funds from current earnings or other company assets to fund that insufficiency.

An employer's contributions to a defined contribution plan (e.g., a profit sharing or money purchase pension plan) are irrevocable. The benefits of plan investment earnings and the risk of plan investment losses rest solely upon the employees. Plan participants will receive at retirement whatever level of benefit may be purchased with their account balances. If investment performance is better than expected, the employee will receive a greater than otherwise expected retirement income. If earnings are less than expected the employee, not the employer, bears that risk.

The tradeoff between a defined benefit and defined contribution plan may be expressed as follows: The employee in a defined benefit plan has security regarding the level of benefits to be provided whereas the employee in a defined contribution plan is at risk with regard to the level of benefits. The employee's benefit is backed by the company that sponsors the plan, by the minimum funding standards and the Pension Benefit Guaranty Corporation ("PBGC").

As recent history has clearly revealed, the PBGC guarantee is not complete protection. The primary protection of employee expectations is the promise of the employer to make the required contributions. In return for accepting the risk of providing employees this protection, the employer retains the right to recover any extra assets which may remain following full satisfaction of plan liabilities. In an ongoing plan, this translates into the potential that future contributions may be reduced if earnings or other plan experiences are better than expected. However, in a terminating plan this is reflected in the right of the employer to recover the excess assets as taxable income.

2. Origin and History of Current Rules. Most retirement plans are no more than a generation old. The period of explosive growth of qualified retirement plans began in the 1950's and has continued until the present time. Prior to the 1950's Congress gradually developed a series of qualification requirements and other rules which employers have relied upon.

The fundamental rules and policies which gave rise to the explosive growth in plans have not changed in 45 years. They have served us well. These rules have stood the

test of time, including the intense scrutiny of two Presidential commissions and the major Congressional restructuring of other aspects of plan operations which was reflected in ERISA.

a. Pre-1950 Period. The provision now incorporated in Section 401(a)(2) of the Internal Revenue Code has its origin in the legislative history of Section 219(f) of the Revenue Act of 1921. That Section for the first time granted tax exempt treatment to a trust established by an employer to provide retirement benefits. The bill as reported by the Senate Finance Committee required that the trust be irrevocable. Sen. Rep. 275, at 16, 67th Cong., 1st Sess. (1921), Seidman, Seidman's Legislative History of Federal Income Tax Laws, 1938-1961 at 850-51 [hereinafter Seidman].

A Senate floor amendment deleted this requirement. The record of the debate reveals that the Senate was aware that this change permitted revocable trusts to qualify for tax exemption. 61 Cong. Rec. 7113, Seidman at 851.

Section 165(a)(2) of the Revenue Act of 1938 provided express statutory authority for reversion of excess assets remaining in a terminating plan. The language of that Section is virtually identical to the current provision of IRC Section 401(a)(2). This language was added by the Senate Finance Committee to a House Ways and Means Committee provision which would have prevented any use of trust assets for any purpose other than providing benefits to the employees. H. Rep. 1960, at 46-48 and Sen. Rep. 1567, at 24, 75th Cong., 3d Sess. (1938), Seidman at 86-87. The House receded to the Senate position in the Conference Committee deliberations. H. Rep. 2330, at 45, 75th Cong., 3d Sess. (1938), Seidman at 87.

The 1938 Senate Finance Committee Report contains the following description of the reversion provision:

> This section of the House bill relating to the exemption from tax of employee's trusts, is retained in the bill, except with a change which is deemed advisable in fairness to employers. Under the House bill an employees' trust..is not exempt from tax if it is possible at any time for any part of the trust principal or income to be used for, or diverted to, purposes other than the exclusive benefit of employees. However, it is quite possible that after satisfaction of all pension liability under the trust, an additional

> amount of funds of the trust will remain, due to erroneous actuarial computations during the previous life of the trust. It seems desirable to allow the employer to provide for the return of such an amount in the trust without the trust losing its exempt status in Section 165. Of course, under the provisions of Section 23(p), the amount recovered by the employer must be reported by him as income. Accordingly, Section 165 of the reported bill provides that an employees' trust will be exempt from tax if at any time before the pension liabilities with respect to employees under the trust have been satisfied, it is impossible for any part of the trust fund, including principal and income, to be sued for, or diverted to, purposes other than the exclusive benefit of employees. Sen. Rep. 1567, at 24, 75th Cong., 3d Sess., (1938), Seidman at 87.

Excess asset reversions were again considered in conjunction with the Revenue Act of 1942. Although the prior acts did not expressly require the employees' trust to be irrevocable in order to be tax exempt, the Ways and Means Committee Report included a statement that irrevocability was a requirement for exemption under the 1938 Act. H. Rep. 2333, at 50, 77th Cong., 2d Sess. (1942), Seidman at 2099. In addition, the House passed version of that bill would have amended Section 165(a)(2) to remove the employer reversion provision. Id. at 103-105, Seidman at 2100.

The bill passed by the Senate restored the asset reversion provisions. Sen. Rep. 1631, at 136-138, 77th Cong. 2d Sess. (1942), Seidman at 2101-2103. The Senate was upheld in this action by the Conference Committee and subsequent passage of the conference bill. H. Rep. 2586, at 52-53, 77th Cong., 2d Sess. (1942), Seidman at 2101-2103.

b. 1950 to the Present. Since 1950 there has been a dramatic growth in the number of qualified defined benefit pension plans. Throughout this period of plan growth no serious effort was made to restrict the right of employers to recover excess assets.

It can be justifiably concluded that a whole generation of corporate managers have exercised the business judgment that their companies should invest in the future retirement security of their employees on the condition and with the express understanding that excess assets could be recovered in the event of plan termination. This reliance interest must not be taken lightly. Under our laws parties who act in justifiable reliance on settled prin-

ciples of law in the ordering of their private and commercial affairs are entitled to protection against legislation or regulations arbitrarily and retroactively defeating those reasonable expectations. Any change in existing laws regarding asset reversions is a serious undertaking and should preserve the basic principles of current law.

3. Policy Implicit in the Current Rules. It is frequently stated that there is no national policy on this subject or that subject. The retirement plan area is no exception. However, this rhetorical technique is often a shorthand form of saying that the speaker opposes existing policy or has not made the disciplined effort necessary to discover that existing policy.

There is a national policy regarding reversions. It is implicit in the rules in effect for so many years. Any principled effort to establish new policy or apply existing policies to new situations should begin with a rediscovery of the existing rules and their policy implications.

The current rules permitting reversions have the following retirement policy implications:

(a) Permitting reversions encouraged sound funding before the funding rules became so complex and inflexible;

(b) Permitting reversions fairly distributes extra assets to the party bearing the risks of funding; and

(c) Permitting reversions encourages the establishment of defined benefit pension plans and restricting reversions discourages formation of defined benefit pension plans. This policy objective has been discussed extensively in Part I above.

The first two policy objectives are discussed in (a) and (b) below.

a. Funding. Actuarial science is an imprecise science. It is unlikely that an employer's contributions when combined with fund experience will actually hit the precise funding target. This is particularly the case when a plan terminates.

Until recently, ERISA funding standards left considerable latitude to a company to choose among several permissive funding methods. Actuaries have tended to err on the conservative side (that is, to require contributions on the high end rather than the low end within the range of

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reasonable actuarial calculations). They have done so with employer knowledge and acquiescence. Even the most confident actuary knows that 30 to 40 year projections of salary, employee turnover and investment rates are only best guess estimates. Incentives toward generous funding are without doubt in the best interests of employees and retirees. Of course these incentives are not the result of sheer altruism. Rest assured they are largely a function of a delicate balance in the law between rules regarding the tax exempt status of plan assets, the deductibility of contributions, minimum funding standards and the right to recover any reversion. To the extent that reversions are restricted, this delicate balance will be upset and the result will unquestionably be less generous funding to the detriment of plan participants.

Prior to termination, a plan's funding rates, methods and factors are conservatively established with a view to their long term reasonableness. For example, a long term funding interest assumption is typically several percentage points lower than current annuity purchase rates. However, when a plan terminates, this long term focus telescopes into a current determination of the cost of purchasing plan benefits through fully paid up annuity contracts. This is the termination funding phenomenon which more than any other factor explains why plans with funding obligations prior to termination are converted into overfunded plans upon termination.

As long as there is any flexibility in the actuarial rates and factors which may be used, employers cognizant of their fiduciary duties to shareholders not to waste corporate assets will only use prudent and conservative funding assumptions if any excess assets which result from such assumptions are recoverable in the event of a plan termination. Thus, the confiscatory excise taxes on excess asset reversions discourage sound funding and increase the risk to employees and the termination insurance system presented by the termination of underfunded plans.

b. Fair Distribution of Excess Assets. When an overfunded plan terminates, all participants, including those who are not yet vested, are immediately vested in all benefits accrued to the date of termination. Before any benefits may be distributed the plan administrator must make provisions

to assure that all benefits are guaranteed by the purchase of annuity contracts or the actual distribution of those benefits.

If the plan provides for mandatory employee contributions any reversion must be shared with employees. Otherwise, if the plan so permits, the excess may be returned to the employer as taxable income.

Before the sponsoring employer may recover the excess assets it must assure the PBGC, the Internal Revenue Service and where appropriate, the Department of Labor that neither ERISA nor the tax laws are being violated and that the plan authorizes such reversions. Under the guidelines issued in May of 1984, special standards apply to so-called "spin off" or "reestablishment" situations. These standards are designed to assure that employers do not benefit from reversions to the detriment of ongoing plans.

Advocates of a new policy do not usually state clearly their intention to deny employers the advantage of investment gains. Rather, they talk in terms of the right of employees or retirees to the benefit of such gains or the need to anticipate future cost of living benefit increases or increases due to future pay increases. However the position is stated, it is bad policy, it is unfair to plan sponsors and it is destructive of employees' and retirees' best interests.

While some companies may provide cost of living increases on an ad hoc basis, they do so when they see a need and desire to do so. They must either increase funding costs or use a surplus to pay for the increased benefits. In the event that an existing surplus is dedicated to such ad hoc increases, it is a voluntary decision and should remain so. No legislation should be adopted mandating such increases whether from surplus or any other source.

Similarly, future salary administration and plan design decisions should not be fettered by the concept that a plan design decision to base benefits on final pay is a permanent decision. Termination of a final pay plan should not trigger an obligation to anticipate and fund the benefits which would result from future pay increases. Employers should be free to exercise their reserved right to amend or terminate their plan at any date and fund

only the benefits accrued at that time. Any other rule will at the very least bring to a rapid halt the practice of many employers of providing final average rather than career average benefits.

We also encourage you to explore alternative uses for excess assets which may solve other difficult retirement income issues. For examples, employers who utilize excess assets for any other employee benefit purpose should be allowed to do so without triggering any taxable event. Existing provisions of the Internal Revenue Code or of the laws which restrict or impede such transfers of excess assets should be amended. Employers should be encouraged to use excess assets in a productive fashion, including a use of such excess assets for funding other employee benefit arrangements including, but not limited to, retiree health or life commitments. Appropriate statutory changes should be adopted to facilitate such utilization of excess assets. Any specific use of excess assets should be a voluntary decision on the part of the sponsor entitled to such excess. In this regard we are opposed to any suggestion that excess assets be used to fund mandatory Cost of Living Adjustments or other benefit enhancements.

We will study closely the recommendations for withdrawals from ongoing defined benefit pension plans in our future deliberations within the Chamber.

III. Is There A Basis For Development Of A Consensus View?

We encourage you to carefully study the terminations which have occurred to date to provide an accurate picture of the actual effects of such terminations. You should include information regarding new plans established thereafter. You may also wish to take note of the productive uses to which reversions have been applied. We believe you will find that many reversions have been used in ways which create jobs and contribute to economic growth.

Make no mistake about the Chamber's dedication to preserving the rights of employers to recover reversions. However, we realize that not all situations are the same. As the administration's policy pronouncement in May 1984 illustrated, not all plan terminations fit neatly within the traditional legal framework permitting reversions. We encourage the development of creative proposals to permit reversions with full protection of participant rights but without burdensome procedural barriers or possibly without a plan termination. In addition, we may be favorably disposed toward creative solutions which permit employers to utilize excess plan funds to provide other unfunded or underfunded employee benefits such as retiree health and life benefits.

We stand ready to work with the members of the Senate Labor Subcommittee to help diffuse the overheated rhetoric which has marked this debate over the past five years.

EXHIBIT

IRS FILING DATA

YEAR	NEW DB PLANS	%	NET NEW DB PLANS	%
1960	5,011	50.33%	4,711	50.12%
1961	4,919	52.40%	4,545	52.53%
1962	5,188	50.77%	4,712	50.35%
1963	5,840	52.40%	5,399	52.67%
1964	6,581	56.21%	6,072	56.92%
1965	7,495	55.39%	6,983	55.88%
1966	10,124	55.68%	9,521	56.09%
1967	11,292	55.03%	10,690	55.64%
1968	12,896	54.23%	12,224	54.72%
1969	14,692	52.33%	13,824	52.47%
1970	16,512	50.69%	15,370	50.78%
1971	22,493	55.31%	20,888	55.96%
1972	28,265	57.29%	26,520	57.88%
1973	33,830	56.76%	31,608	56.98%
1974	32,579	54.86%	30,002	54.95%
1975	15,319	51.00%	10,769	49.10%
1976	4,790	17.03%	(4,180)	-54.47%
1977	6,953	19.63%	1,576	8.07%
1978	9,728	14.81%	5,092	10.11%
1979	15,755	27.70%	12,483	27.13%
1980	18,849	27.18%	14,543	25.96%
1981	23,789	29.18%	19,247	28.28%
1982	28,189	33.03%	23,134	32.97%
1983	22,130	34.46%	14,890	32.70%
1984	12,807	31.17%	3,637	17.42%
1985	17,267	36.26%	5,037	23.38%
1986	22,076	32.88%	11,348	27.16%
1987*	15,824	28.43%	5,122	16.29%
1988**	16,812	26.66%	5,236	13.52%

YEAR	CITATION
1960	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1961	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1962	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1963	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1964	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1965	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1966	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1967	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1968	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1969	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1970	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1971	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1972	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1973	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1974	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1975	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1976	DOL, Handbook of Pension Statistics 1985, Table 30 (1986)
1977	IRS News Rel IR-1973, 4 CCH Pen Plan Guide P 17,016U (3/23/78)
1978	IRS News Rel IR-2090, 4 CCH Pen Plan Guide P 17,017N (2/8/79)
1979	IRS News Rel IR-80-47, 4 CCH Pen Plan Guide P 17,018 (4/7/80)
1980	IRS News Rel IR-81-23, 4 CCH Pen Plan Guide P 17,018I (2/27/81)
1981	IRS News Rel IR-82-40, 4 CCH Pen Plan Guide P 17,018S (3/30/82)
1982	IRS News Rel IR-83-72, 4 CCH Pen Plan Guide P 17,019F (4/21/83)
1983	IRS News Rel IR-84-62, 4 CCH Pen Plan Guide P 17,019Q (5/17/84)
1984	IRS News Rel IR-85-24, 4 CCH Pen Plan Guide P 17,019X (3/8/85)
1985	IRS News Rel IR-86-113, 4 CCH Pen Plan Guide P 17,020K (8/21/86)
1986	IRS News Rel IR-87-97, 4 CCH Pen Plan Guide P 17,020U (8/19/87)
1987 *	9 month period ending 9/30/87
1987	IRS News Rel IR-87-97, 4 CCH Pen Plan Guide P 17,020U (8/19/87)
1987	IRS News Rel IR-89-9, 4 CCH Pen Plan Guide P 17,021C (1/23/89)
1988 **	12 month period ending 9/30/88
1988	IRS News Rel IR-89-9, 4 CCH Pen Plan Guide P 17,021C (1/23/89)

Senator METZENBAUM. Thank you, Mr. Kelly. I think I am going to ask questions separately of each of the witnesses. I found it interesting that even you testifying with the U.S. Chamber referred to the scavenging of the assets, and I think that indeed is an appropriate phrase that I had never used before. But I think it really describes it well. Now there is not any senator that I know, any congress person that I know who wants to take any action that will adversely affect the right and opportunity of employers to create funds—defined benefit plans.

I think what we are talking about has to do with the question of what you do with the excess funds. Frankly, I do not think the employers have commented on this, but it was not me talking about the use of these additional funds. Whoever came up with the idea of the 10 percent tax, and I do not know whose idea it was, saw this pot of money out there and said hell that is a good way to balance the budget; let us take 10 percent of it. So then they went up, not at our urging at all, to 15 percent. And when there was a provision for 60 percent tax talked about, that was understood as not being an effort to raise, but that was a way to shut the door until such time as the matter could be resolved.

Now, I have difficulty in understanding why so often in the legislative process, we find one group over here and one group over there, and this lack of willingness to come in and try to find a reasonable solution. We have never maintained that all the money belongs to the workers. We have said let us be reasonable about it; let us find what is a fair and equitable solution. And as a matter of fact, when we had people like Bob Monks, who at that time was head of the pension division of the Department of Labor, I remember he had concerns about what was taking place. And we spent much time with him. And I think at this time—can we just take a moment, please—where he says in April of 1985 after he had left the Department. He says, "after a great deal of thought"—it is set forth on pages 34 and 35 of the enclosure—"I have come to the conclusion that there is a serious question of violation of existing law in the termination reversion process." In other words, and I am quoting from him, "If the inflation-indexed Government bond produces exactly the needed results, what excuse can there be to incur any risk to achieve results which are surplus, and therefore by definition, not for the exclusive benefit of the plan participants? For whom is the manager managing? The statute and its exclusive benefit rule are unmistakable in stipulating that all plan assets must be held solely for the benefit of the participants. And yet the existence of pension plans is wholely voluntary. Any excesses above vested benefits can be returned to the corporate sponsor in the event that he, in his uncontrolled discretion, decides to terminate the plan. Many companies have, in fact, terminated their plans in recent months—and that is not a quote from him, that is a quote that he is quoting from. Obviously if the law is being violated by existing practices, substantial leverage exists to work out more equitable solutions than those occurring in the past two years."

And that is from a man who is in the issue, involved with the Labor Department. What I have tried to say is why cannot we sit down and reason together and work out a plan, so that it does not fall into the tax department, but that the funds be used for those

for whom it was intended to be used, for the workers, and if there is too much, let the employers have some of it.

I would like to say to you that we would be prepared to negotiate, to discuss, to work with the U.S. Chamber of Commerce or any other corporate employer group to come up with a reasonable solution to this problem, rather than waiting to see who has got 51 votes in the United States Senate on a particular day or 218 votes in the House on a particular day.

Mr. KELLY. Mr. Chairman, we are always glad to have the opportunity to work with you and with the subcommittee, with this committee, but it is important that in approaching that effort we not be surprised when reasonable people act as normal, economic beings. It is important to remember that corporate executives owe a fiduciary duty to shareholders, and as often as not those shareholders have pension plans. And their duty in establishing plans and other employment arrangements is to spend that money wisely, cost effectively, producing the benefit that is intended. But if an unexpected diversion of corporate funds is either going to happen or threatened, then they will act reasonably.

It is interesting that as we have seen the last two years a dramatic dip in net formations, those are also the years when the termination rates have been dropping. So we are talking about the gross number of new formations going down dramatically in the last couple of years of the defined benefit variety. We are not talking about the largest companies in the country. They are in the defined benefit universe and they are in for the long haul. We are talking about the companies that may be our next generations' largest companies in the country and will never be in the defined benefit universe, if the mechanism does not work in the economic best interest of the shareholders and of the employees, as well.

Senator METZENBAUM. You say, you are not talking about the largest companies. Let me say to you that you sure in the devil are. I have seen some of the major giants of this country. Would not you say that Exxon?

Mr. KELLY. No, when I am talking about net formations, they would be a wash if they are going to terminate and set one up. They are going to be a wash in the figures I showed you.

Senator METZENBAUM. Yes, but the big companies have certainly been involved. Look at the list: Ashland Oil, Cities Service, Exxon, Getty Oil, Occidental Petroleum, Pennzoil, Philips Petroleum, Superior.

Mr. KELLY. But, Mr. Chairman, in the figures I showed you the trend line, where we are going with defined benefits, they will net out. They will have a new plan formed and an old one going out, and they will net out as a zero.

Senator METZENBAUM. Some will and some will not. And when they do that will not mean that there will be any allowance or consideration made for cost of living adjustments. And let me point out to you that the point is you were saying, that the employer has a fiduciary obligation in connection with the pension plan.

Mr. KELLY. To the shareholders as well as to the employees.

Senator METZENBAUM. I just ask the employer to bring that same kind of fiduciary responsibility, fiduciary obligation to his or her handling of the pension fund excesses that he or she maintains in

determining whether or not there should be a golden parachute. Just the same, nothing more. Of course there is a fiduciary obligation there, and employers have turned their backs upon their stockholders and their workers as well, and taken the golden parachute. Just consider those people are out there that made the company for 20 and 30 and 40 years. Many times far longer than the executive whose taking a golden parachute for himself or herself.

Mr. KELLY. It is important to remember, Mr. Chairman, that in a termination reversion situation, you are talking about employers who have kept their promises. They have paid under the law, as the law requires. They have paid the full benefit. They have funded it through an insurance contract or through a lump sum payment of a value that new stricter rules that build in a cushion as to what the interest rate is used and other factors. It is also important to remember, Mr. Chairman, that you are a very well known spokesman of a moratorium position and your voice has great impact in corporate board rooms. Probably more than you even realize.

And there are alternatives to defined benefit plans. And when they feel that you or your colleague, Congressman Roybal, are about to do something that will mean that corporate assets will eventually go to an unintended purpose over and above the benefits that were the focus of the promise from the employers point of view, then they simply will not make the promise in that way. They will set up a defined contribution plan.

Senator METZENBAUM. Let me say, Mr. Kelly, let me leave you with a last message and that is, we have indicated to the Labor Department that we are prepared to work with them. We are prepared to work with you and the Chamber of Commerce. We are prepared to work with the AARP, with the AFL–CIO. We are prepared to work with the Treasury Department. We would like to bring about a solution to this matter, and I would say to you as the Chamber of Commerce or the AFL–CIO or to anybody else, that seldom does Congress come up with the optimum solution when it is based upon who has got the most votes. Quite often we come up with a good solution when it is a negotiated conclusion. And I can think of a number of instances of that kind. We are prepared to work with you promptly if the U.S. Chamber is inclined to do so.

Mr. KELLY. I am confident that our members will be, as well. Thank you.

Senator METZENBAUM. Thank you. Our last witness is Mr. Vance Anderson, speaking for Mobil Oil Corporation.

Mr. ANDERSON. Thank you, Mr. Chairman, actually I am speaking on behalf of the Association of Private Pension and Welfare Plans. I am employed by Mobil Oil Corporation, but I appear on behalf of the Association today. We have filed a statement with the Committee, and with your permission I would like to summarize my testimony and have this statement incorporated as part of the record.

Senator METZENBAUM. Both of your entire statements will be included in the record.

Mr. ANDERSON. Mr. Chairman, it is with some trepidation I report to you that the association continues to consider the question of asset reversions and overfunded plans, and having watched you this morning and understanding what your position is, I am

sorry to tell you that we still wish to express a very grave and deeply held reservations with some of the proposals that we have reviewed in the last several months. I understand that you will be introducing a new proposal later this month and we will, of course, analyze it and review it very carefully.

Let me tell you what the basis for our concerns are. We are concerned that limitations on reversions may be perceived as raising the financial risk to employers of overfunding, leading them inevitably to lower their funding standard targets, to thin up on their funding, to avoid the risk of having too much money in these plans. If, in fact, let us say a proposal that any excess assets would have to be shared with either employees or with retirees, that they will simply avoid that risk and they will do so to the long-term detriment of their plans and the pension system.

If you were to create this disincentive to fund on a generous basis and create an incentive to employers to thin out their funding or to fund on the thin side, you would not substantially effect in our opinion, you would not substantially effect the rate of plan terminations, but you would most certainly reduce the number of overfunded plans that were terminated.

Senator METZENBAUM. Do not you think, Mr. Anderson, that part of the reason for some cutting back on the funding of the pension plans relates directly to the tax rate. As the tax rate goes up, there is an inclination to fund it more heavily with the thought that that money might be usable with respect to future endeavors of the company and future employee relations. As the tax rate came down at 28 percent, there was somewhat of a lesser incentive to put more money away in the pension plan.

Mr. ANDERSON. With all due respect, Mr. Chairman, I have heard that argument from tax theoreticians, and I must confess to you that it does not square with any experience that I have had or any experience of those who are, in fact, involved in making funding decisions for corporations. I think it would be more accurate to say that over the last, looking at funding rates in major plans over the last five years, that the very good experience that the plans have had with respect to their investment returns has led them to reduce their funding because they are now anticipating for the future much lower rates of return than they would have anticipated, let us say in the time frame 1979, as opposed to 1989.

Second point, Congress has acted on four occasions in the last six years to substantially reduce the ability of employers to fund these plans. Now that has been done with a concern, perhaps legitimate, perhaps not, but nonetheless a concern expressed by Congress and articulated in legislation that employers are, in fact, putting too much money into these plans.

Thirdly, I would point out to you that the interest rates—well, I think I have given you two good reasons which I think are unrelated to tax rates. I simply do not think that a major employer, certainly not my company or any other company that is going to be in business or providing a defined benefit pension plan to its employees can afford that. We do not do a good job of playing interest rate plays on a six-month or 18-month basis and we do not do a very good job of anticipating which way tax rates are going to move.

Senator METZENBAUM. You said Congress has acted four times to dissuade employers, as I remember you saying, from adequately funding these plans, and I am not sure I follow you.

Mr. ANDERSON. Yes, you are getting the point. It is a little bit out of order, but let me just suggest to you on the issue of retiree medical expenses, for example. I think you have suggested and perhaps others have suggested that making more adequate provision for retiree medical expenses by using or applying surplus assets might be an appropriate policy direction to have. Perhaps I misstated the case.

Senator METZENBAUM. I think business has been suggesting that. I do not think I have actually commented favorably or unfavorably.

Mr. ANDERSON. Perhaps it was Secretary Walker who made reference to it. I can recall quite vividly, Senator, in 1986, if I am recalling my dates correctly, coming up to lobby the Ways and Means Committee to convince them that it would be appropriate—members of the Ways and Means Committee—attempting to convince them that it would be appropriate to allow employers who wish to do so, on a purely voluntary basis, to put money aside in a 501(c)(9) trust to provide an asset cushion to assure the payment of retiree medical expense.

Now it was rejected on revenue grounds. If I recall correctly, it may have been an earlier bill than that, Senator. But if I recall correctly within the last two years, we have had a new full funding limitation that is now measured as 150 percent of the current liability of the plan. Now for an employer that is a young, dynamic, growing employer with a fairly young work force, they may have a very small current liability which is to say a liability that would arise if they were to terminate the plan.

But on a projected basis looking at over 20 or 30 years, they are going to have a very substantial liability that would be responsible for that employer to fund not for the lower current liability, but rather to fund for the projected liability. And I think the tax laws now tell us that we cannot fund for more than 150 percent of the current liability, whatever relationship it may have to the projected liability.

I would also point out to you that, and this gets me in a little touchy ground, but there is a relationship between sections 404 and 415 in the Internal Revenue Code that prohibits us for funding for projected benefits which are in excess of a certain minimum. Now it may well be from a policy standpoint that the minimums expressed in section 415 are eminently rational if you are looking at benefit payments today or tomorrow. But again when you project those amounts out in terms of benefits that might become payable in the year 2010, and consider whether or not you are funding an adequate amount for those, the answer is we are clearly not.

Now those are examples, Senator, where funding has been restrained. The concept that has been adopted by Congress in those areas is that employers have put too much money away. Now I suspect that that viewpoint may be motivated by the fact that there is an attention being paid by the Finance and the Ways and Means Committees to the existence of surplus assets in some sense that they can push down funding levels across the board and have some reassurance that the Treasury, for example, I am getting way

beyond my depth here, but that the tax writing committees may wish to look at surplus assets and feel that they may be in an appropriate place to create some slack and to raise revenue in this time of difficult budget situations.

If I may, let me get back and make a couple of quick points here, if I can. We are concerned about the economic incentives to fund. We think that the soundness of the system requires that the incentive to the employer to fund on the high side, which is to say that if he is going to make an error in his funding estimates, error on the side of putting too much money in, it is all too easy for the Senate and the House to act in a way which will create incentives for people to err on the side of not putting quite enough money in.

Let me also suggest to you that when you look at the interests of the various parties who share in the pension promise or have responsibility for making it, you have got not only retirees and those who are close to retirement, not only is the employer a party to this, but you also have the interest of active employees too. And it may be that in some circumstances when you terminate an overfunded pension plan and reallocate those assets, the excess assets, as you have described them, I believe in terms of general corporate purposes, that those general corporate purposes may well be beneficial to active employees to the extent that they provide additional assurance that employment will continue. Or for that matter that other nonretirement benefits may be payable.

In most of the cases that we have heard this morning, some very tough difficult business decisions are being made in the context of strained economy or strained local economy and a tough competitive posture for the employer. It may be that the plans are terminating or that a plan will be terminating in the context of a down size up. In that case, you have got younger employees who are confronted with the possibility of layoff or termination. You may find that some of those general corporate purposes to which excess assets are being applied may well work for the direct benefit of those younger employees who are no where near retirement age and have no direct immediate interest in the retirement benefit.

For example, they may be very interested, but they may be very interested in severance benefit payments or retraining assistance or any other of nonretirement benefits which are directly available and which would be very helpful to the younger worker in that context.

Let me also mention in passing and let me leave it at passing, if I may, that we want to be very careful and I know you want to be very careful that we do not increase our labor costs via directly or indirectly without being very careful and giving due regard to the competitive situation that our work force has to maintain or be involved with in the world market place.

[The prepared statement of Mr. Anderson follows:]

APPWP
Association of Private Pension and Welfare Plans

Statement of the

Association of Private Pension and Welfare Plans

before the

Labor Subcommittee
of the
Senate Committee on Labor & Human Resources

On

"Employer Asset Reversions From Terminated Pension Plans"

Thursday, February 9, 1989

Vance J. Anderson
(witness)
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Member, Executive Committee, APPWP Board of Directors

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INTRODUCTION

Mr. Chairman, and members of the Subcommittee, my name is Vance J. Anderson. I am the Employee Relations Counsel for Mobil Oil Corporation and I serve on the Executive Committee of the Board of Directors of the Association of Private Pension and Welfare Plans (APPWP). I am testifying on behalf of the APPWP, a non-profit organization founded in 1967 whose primary purpose is to protect and foster the growth of this country's private pension and employee benefit system. The APPWP's members represent hundreds of employer sponsors of pension and benefit plans as well as leading support organizations to benefit plans such as investment firms, banks, insurance companies, and accounting and actuarial firms.

We thank you for the opportunity to testify on the issue of pension reversions. We have paid close attention to the debate over reversion policy and in particular your initiatives in this troublesome area. We continue to believe that changes in the law to further restrict or prohibit reversions will have negative effects on the pension security of participants in defined benefit plans.

We are firmly convinced that defined benefit pension plans are the most secure and reliable retirement vehicles available today. In the past several years, these plans have been battered by

legislative and regulatory changes, which too often were designed to raise revenue rather than enhance retirement income security.

This overregulation has had a negative effect on the willingness of many employers, especially small employers, to either initiate or continue defined benefit pension plans. In our view, the changes enacted by Congress in recent years, including legislative initiatives related to reversions, have dramatically increased employers' concerns about sponsoring defined benefit plans for employees.

NATURE OF THE PENSION PROMISE

The APPWP believes that the continuing concern directed to the issue of reversions from overfunded pension plans is misplaced. We believe that reversions from overfunded plans are appropriate in consideration of the nature of the pension promise that an employer makes to an employee through a defined benefit plan. That promise is a pledge to pay to an employee, upon retirement, a specified benefit calculated according to the formula that is required to be set forth in the plan documents. The employer's promise is not conditioned upon the availability of funds in the pension plan at any given time. Unlike defined contribution plans, participant do not bear the risk of poor investment performance. That would be a result inconsistent with the nature of a defined benefit plan and the law requires plan sponsors to dig-deeper into their own pockets

to pay benefits if the assets of the plan are insufficient to pay promised benefits.

It is often argued by opponents of reversions that employer contributions to defined benefit pension plans represent "deferred wages" to the employee and therefore all the assets of the plan belong to the participants. Even assuming, arguendo, that the concept of deferred wages has application to this issue, the "deferred" element relates to that portion of current wages given up in exchange for a promise of a specific benefit upon retirement. As long as the employer fulfills the promise to pay that benefit, as required by law, the exchange of value implicit in the deferred wage theory is achieved. Thus, any surplus assets remaining after all the liabilities to employees have been discharged logically belong to the employer.

By definition the amount of surplus assets which are subject to reversions to an employer upon termination of a plan are limited to those amounts remaining after all promised obligations are discharged to plan participants either through the purchase of annuities or through lump sum payments. Moreover, a frequently overlooked point is that upon the termination of a defined benefit plan, all participants are immediately vested in all benefits accrued to the date of termination. The surplus is then determined from the amounts left over and, of course, excise and income taxes are imposed on the amount determined to be returned to the plan

sponsor. No one gets less than was promised as a result of termination.

Rather than focusing on overfunded plans, we believe that Congress should turn its attention to underfunded plans. It is those plans that pose the greatest risk to participants in the private pension system. Inadequate funding threatens the retirement security for retirees, imposes additional costs on those employers with adequately funded pension plans who participate in the pension insurance system and, ultimately, may involve a further drain on taxpayers if that system cannot meet its obligations. Well-funded plans pose no such threats and should be encouraged. The APPWP is concerned that the "cure" for the "problem" of excess asset reversions may result in a greater number of plans being terminated with insufficient assets--a perverse result which will benefit no one.

BACKGROUND TO REVERSIONS

Congress has consistently supported an employer's right of reversion. In the legislative history to the Revenue Act of 1938, for example, the Senate Finance Committee noted that "...(I)t is quite possible that after satisfaction of all pension liabilities under the trust, an additional amount of funds of the trust will remain... It seems desirable to allow the employer to provide for the return of such an amount in the trust without the trust losing its exempt status..." That policy has continued to the present day

including ERISA Section 4044 which specifically reserves for employers the right of reversion of surplus assets.

The rules permitting reversions have, in the past, and continue to be rooted in sound retirement policy objectives. The first objective is that allowing employers to retain surplus assets in the event of a termination encourages the establishment of defined benefit plans. Secondly, that permitting reversions encourages employers to fund those plans responsibly. Thirdly, that reversions distribute surplus pension assets to the entity that bears the risk of funding the plan.

Actuarial science is not an exact undertaking and all plans will normally be either over or underfunded. Indeed, the concept of "actuarial error" is a common and accepted term. Of course surpluses do not typically occur as a result of actuarial error. For the most part, surpluses arise because defined benefit plans are funded on a so-called "projected" basis while the determination of assets in a plan upon termination is calculated on a "current" basis. It is altogether appropriate that this should be done. For as long as the plan is an ongoing entity, the employer should fund for projected benefits that will be paid. Indeed, employers strongly support both the spirit and letter of the law that requires that funds in ongoing plans are to be used for the exclusive benefit of participants. However, in those circumstances in which a plan terminates, for whatever reason, an assessment of the funded status of that terminated plan must logically be made on a current basis

because future benefits will no longer be paid from the plan. As long as benefits promised and earned are discharged to participants, fairness dictates that employers should be permitted to retain the surplus.

Policies that have permitted reversions recognize that unless employers are allowed to retain surplus assets--and thus not give retirees more than the amounts for which the employers and employees have negotiated--companies will be less likely to establish and adequately fund defined benefit plans. Ironically, restricting reversions penalizes those very employers who have been the most conscientious in funding their plans. Congress has recognized that if employers are penalized in this way, corporate support for the private pension system will be eroded.

TRENDS IN REVERSION ACTIVITY

Quite apart from the philosophical reasons for not restricting reversions, there are very practical reasons for not legislatively curtailing reversions: the rate of termination/reversions has never been very high in comparison to the total number of private pension plans--and the pace is slowing.

Of the hundreds of thousands of defined benefit plans in existence in the years 1980 through 1988, only 1,897 plans had terminated with reversions in excess of $1 million. At the "height" of reversion activity, in 1985, there were only 582 reversions of more than

$1 million involving $6.1 billion worth of reverted assets. For 1988, the number of reversions had dropped to 166 involving $1.8 billion in reverted assets. While those numbers may seem high, it should be remembered that the nation's private pension system has assets of approximately $2 trillion. Thus, the amount of pension assets reverted is a very small percentage of the total money in the pension system.

Opponents of reversions often charge that employers terminate their plans and leave the participants with no income security. As mentioned previously, when a plan terminates, all plan participants became vested in their earned benefits. And, as the data shows, in most instances employers establish successor plans. Of the reversions that took place in 1988, for example, fully [illegible]1% of the participants were in plans in which there was a successor defined benefit plan, and another 44% were in plans for which there was a successor defined contribution plan. Only in 15% percent of the cases was there no successor plan, and in most of those instances it can be assumed that the company terminating the plan was going out of business. The Tax Reform Act of 1986 imposed a 10% excise tax on reversions and that has slowed reversion activity. The Technical and Miscellaneous Revenue Act of 1988 has increased the tax to 15% which undoubtedly will further chill reversion activity.

These statistics suggest that termination/reversion activity, which has always been minor in the overall scheme of the pension system, has slowed even further in the past few years and in the vast number

of cases where there are reversions, employers are replacing terminated plans with new plans.

THE IMPLICATIONS OF RESTRICTIONS ON REVERSIONS

Defined benefit plans represent the nation's single largest accumulation of funds for long term capital formation. Pension funds account for 34.8% of the investment capital supplied by financial institutions other than banks and thrifts in 1986. These plans provide the investment base for American industry. Thus, to the extent that funding of these plans is discouraged, their investment support is eliminated as well. As we discussed previously, restricting reversions, in effect, penalizes those firms that have maintained the most fiscally sound pension plans. To the extent that the pension arena continues to be overregulated and companies are discouraged from responsibly funding their plans, the remaining participants in the nation's termination insurance system will be those companies with comparatively less well-funded plans. Inevitably, this will mean further future hikes in Pension Benefit Guaranty Corporation (PBGC) premiums to support that system; and the willingness of many firms with well-funded plans to remain committed to the defined benefit plan system will be eroded.

Certainly it cannot inure to the benefit of either retirees or the employers who support the pension insurance system, to duplicate the experiences of the federal insurance system for the savings and loan industry. It need not happen. But if large companies with well-funded plans retreat from the defined benefit system (or fund

their plans less generously) and if small companies where most of this nation's job growth is occurring are dissuaded from establishing defined benefit plans; the remaining employer participants in the PBGC insurance system will be those that are less financially capable of supporting the system.

In the end, as financially secure employers are driven away from participation in the pension system, it will be incumbent upon government programs and the taxpayers to provide benefit security for retirees from companies with less well funded plans. That is a result which we all must work to avoid.

RETIREE HEALTH BENEFITS

The issue of funding liabilities for retiree health benefits is a complex and important issue that rightly deserves separate hearings. For purposes of today's inquiry, suffice it to say that unfunded retiree health liabilities for many companies, are a significant problem. The impending requirement to reflect these liabilities directly on a firm's balance sheet and income statement will pose serious financial implications for companies and force them to rethink their commitment to providing retiree health coverage.

Mr. Chairman, you have been a leader in the effort to ensure retiree health protection for Americans and we note, in particular, your support for legislation passed in the last Congress to help ensure

the continuation of retiree health coverage for retirees of companies in bankruptcy. Congress has the opportunity to both help address the dilemma over funding retiree health benefits while moderating the debate concerning reversions. It is in this spirit that we once again propose an alternative use of surplus pension assets.

The APPWP has frequently in the past advocated that Congress permit employers to use surplus assets in pension plans to help fund retiree health liabilities for both current and future retirees. In advocating this position, we should be clear about two points. First, any use of surplus pension assets for this purpose must be purely voluntary on the part of the employer plan sponsor. In no way should this permissive use of surplus pension assets interfere with the employer's ultimate right of reversion which we have described at length above. Second, pension surpluses do not represent a panacea for solving the problem of funding retiree health obligations. It is only a partial solution; but one worth pursuing. Use of pension surplus assets for retiree health benefit needs may help address one serious retiree benefit issue. If surplus pension assets are allowed to be used to help fund retiree health liabilities, employers will be provided some relief for their large retiree health obligations and retirees will be made more secure in their ability to have health care coverage.

CONCLUSION

In summary, the AP?WP strongly urges the Congress to continue its long-held position that permitting reversions is an important right for employers which helps maintain their support for the private pension system. Restricting the availability of reversions will have serious negative implications for the financial soundness of pension plans and will work to the detriment of participants and retirees. In addition, we urge Congress to consider allowing employers to use surplus pension assets to fund retiree health benefit costs.

Senator METZENBAUM. Mr. Anderson, let me say that this Senator has no plans in this legislation to do anything to increase your cost. And I have heard the matter of competitive work place in competition with our international competitors on almost every bill that we have had. No matter what the bill, we are not on that side of the ledger. We are on the side of the ledger of how much you ought to take away from the employees. I want to point out to you, Mr. Anderson.

Mr. ANDERSON. Senator, it is a cruel equation, but I do not mean to disagree with you, but I sometimes have to tell you that I get tired of reminding myself about this, but if there is a deal out there—one deal—let me put it in fairly direct terms. Terms that I would prefer not to see applied when we are talking about a defined benefit plan and the interest of the participants in that plan. But if there is a deal out there where the economics of it hinge on getting a reversion to make it fly, the issue would be joined at that point. I think none of us like the proposition that a transaction is going to turn on the availability of surplus assets and yet you have read in the paper, I have read in the paper where there obviously are transactions where, in fact, it will turn on the availability of those excess assets. And that is to say, continued employment will turn on the availability of those excess assets. I did not mean to interrupt you, I am sorry.

Senator METZENBAUM. Let me say that I read something recently that said about employers having an obligation, and we like to call these different groups and others stakeholders because all of them have a stake in the company. They are shareholders, employees, customers, bondholders, suppliers and pensioners, and it goes on to say that we have to satisfy their employees' wishes for good wages now and a financially healthy company that can continue to provide long-term employment. And then the article goes on to point out that recently the balance has been upset because new financing instruments such as junk bonds, either through takeovers or threat of takeover, force companies to look only at the short-term and they have been forced to cut research and raid pension reserves.

Those are concerns, that I have, and I am sure you would have them as well. I think that is what we are talking about.

[The Mobil Corporation article, Shareholders, Stakeholders, and the Long-term View follows:]

Shareholders, stakeholders, and the long-term view

American corporations perennially have to walk a tightrope between short-range and long-range objectives. They have to fulfill their shareholders' wishes for short-term dividends and long-term growth. They have to meet their customers' desires for less expensive products today, while undertaking the costly research and development that will provide better products tomorrow. They have to satisfy their employees' wishes for good wages now and a financially healthy company that can continue to provide long-term employment.

We like to call these different groups, and others, "stakeholders," because all of them have a stake in the company. They're shareholders, employees, customers, bondholders, suppliers, and pensioners. They're neighbors as well—those who breathe the air near a company's installations, and drink the water. They include the schools, hospitals, and cultural institutions that receive corporate assistance. In a broader sense, it could be argued that all Americans are stakeholders, because the country as a whole eventually feels the impact of how well American business operates and competes, not only in this country, but internationally.

Over the years, most corporations have become pretty good at this balancing act. Short and long-range goals are not mutually inconsistent. They can both be met if the company makes careful choices and explains to its stakeholders why these choices were made. Stakeholders are sensible people and most realize that no company is rich enough to do everything everyone wants all at once.

But recently, this balance has been upset. New financing instruments—such as junk bonds—have allowed some individuals, either through takeover or threat of takeover, to force companies to look only at the short term. Such companies have been forced to take on debt and pay out their long-term capital in short-term dividends. They have been forced to cut research or raid pension reserves.

If the trend continues, will domestic companies be able to provide America's new products and new technology, or will they come from Europe and the Far East? What happens to the commitment to clean air and clean water that now may extend well beyond the letter of the law? Will companies be able to meet their pension obligations and continue to provide medical benefits? Will they be able to be good corporate citizens supporting community projects and services?

These are serious questions spurring serious debate and genuine concern. We don't pretend to have the answers, but we would like to urge attention to three points we think are critical but not often discussed.

First, this is indeed a problem for all stakeholders, including the American public as a whole. It cannot be viewed as a problem for a few unfortunate companies.

Second, we hope that our combined national wisdom finds ways to address the problems through free-market forces. We worry, for example, about changing the tax code to discourage junk bond borrowings. Making rules that distinguish between "good" borrowing and "bad" borrowing will be difficult, risky and probably arbitrary. We have difficulty seeing how a federal arbiter can make these distinctions. The marketplace usually works better if sensible ground rules are established.

Third, we urge others in our society to speak out more loudly on this issue and we urge the media to give this debate a lot of space and time. The problem is a real one and its potential impact is, we think, largely underestimated. Only through a vigorous debate will solutions finally emerge that meet the interests of all the stakeholders—and the nation as a whole.

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Mr. ANDERSON. Senator, I am not disagreeing with you one bit. My point to you is a different one. As far across the table as I can come to be on your side in those issues, I would still suggest to you that both you and I would want to be very cautious with respect to this other issue that I have raised.

Senator METZENBAUM. Mr. Anderson, I am very cautious. I just said to Mr. Kelly, come let us reason together. I say to Mr. Anderson, let us reason together, and at this point I will put in the record the fact that Mobil Corporation wrote the article from which I was quoting.

Mr. ANDERSON. I had the feeling I would not disagree with the content of that article.

Senator METZENBAUM. I did not think so. I have put that in the record. I would say in concluding this hearing that this Senator has been on this subject for a long time. And I have six more years to keep working on it. I would like to finish it in the next six weeks with the assistance and cooperation, hopefully, of my ranking member of this Subcommittee. My former ranking member got dumped off this Committee by becoming Vice President, and I think that indicates a good future for you Senator Jeffords. But we are prepared to negotiate promptly, reasonably, equitably. I came out of the business world. I evolved the leadership role with companies in the New York Stock Exchange, American Stock Exchange, the over the counter market, my own companies. I do not want to do anything unreasonable. But I get the feeling that the new Administration is prepared to move somewhat on this issue. That being the case, I am certain the new Administration would agree that they would be ecstatic if the business community and the labor community were to move rapidly forward in trying to work out an acceptable compromise. We do not want to do anything to adversely affect the business community, the economy, or the competitiveness of this country.

Having said that, I am about ready to close down this hearing, unless my ranking member has anything further to add.

Senator JEFFORDS. No, thank you, Mr. Chairman, I appreciate this hearing very much. Sorry I had to be absent for part of it, but I can assure those that I missed that I will be reading their testimony because I have a deep interest in a good sound resolution to this very difficult issue.

Senator METZENBAUM. Thank you very much, and I want to say to both Mr. Anderson and Mr. Kelly that I think that your testimony and your presentation was very reasoned and well intentioned, and I hope that we can work together on this subject. Thank you.

The hearing stands adjourned.

[The following was submitted for the record:]

RAM & Co.,
Washington, DC., April 25, 1985.

Hon. HOWARD M. METZENBAUM,
U.S. Senate,
Washington, DC.

DEAR HOWARD: I continue to spend a great deal of time thinking about ERISA needs and enclose for your consideration the rather detailed valedictory that I prepared following extensive hearings in January.

I have thought particularly about concerns you have voiced relating to the termination of pension plans and the reversion of surpluses to sponsor corporations. After a great deal of thought—it is set forth on pages 35 and 36 of the enclosure, I have come to the conclusion that there is a serious question of violation of existing law in the termination reversion process. "In other words, if the inflation-indexed government bond produces exactly the needed results, what excuse can there be to incur any risk to achieve results which are surplus, and therefore by definition not for the exclusive benefit of the plan participants? For whom is the manager managing? The statute and its exclusive benefit rule are unmistakable in stipulating that all plan assets must be held solely for the benefit of the participants. And yet the existence of pension plans is wholly voluntary. Any excesses above vested benefits can be returned to the corporate sponsor in the event that he in his uncontrolled discretion decides to terminate the plan. Many companies have, in fact, terminated their plans in recent months."

Obviously if the law is being violated by existing practices, substantial leverage exist to work out more equitable solutions than those occurring in the past two years.

Respectfully yours,

ROBERT A.G. MONKS, *President.*

Enclosure.

[Note: Enclosure not available for printing.]

[Whereupon, at 12:05 p.m., the subcommittee adjourned, subject to the call of the chair.]

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